Supreme Court, U.S.
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In The

Supreme Court of the United States

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AKS DAKS COMMUNICATIONS, INC.;
SMR ADVISORY GROUP, L.C.; AND
ALBERT KOENIGSBERG,

Petitioners,

v.

ARIZONA CORPORATIONS
COMMISSION; RENZ D. JENNINGS,
COMMISSIONER; MARCIA WEEKS,
COMMISSIONER; AND CARL J.
KUNASEK, COMMISSIONER,

Respondents.

◆

On Petition For Writ Of Certiorari
To The Supreme Court Of Arizona

◆

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the authorities below, the Supreme Court of Arizona, the Arizona Court of Appeals, the Superior Court of Maricopa County, and the Arizona Corporations Commission, have denied Petitioner's constitutional due process rights via reliance on a non-participating, non-credible witness in contradiction of all participating and credible witnesses, and thereafter the remaining courts refusal to examine same, notwithstanding that such was an abuse of discretion, and an illegal, arbitrary and capricious act under Arizona law?

2. Whether Petitioner's constitutional right to freely associate was violated by enjoining it and its co-members' right to join together in limited liability companies in their radio dispatch business?

3. Whether Petitioner's constitutional due process rights were denied because the administrative hearing and subsequent hearings were predetermined, and resolved by the authorities below, notwithstanding the record?

PARTIES NOT IN THE CAPTION

The Petitioners have no parent corporations, nor any non-wholly owned subsidiaries.

TABLE OF CONTENTS

Page

CITATIONS TO LOWER COURTS' OPINIONS...... 1

JURISDICTION.................................... 1

STATEMENT OF THE CASE...................... 2

REASONS FOR GRANTING THE WRIT 11

I. The Petitioner's Due Process Rights have been Violated by the clearly erroneous, arbitrary and illegal actions of the Commission, and the Arizona courts' subsequent refusal to fully review such actions in its depiction of the hearing evidence which was contrary to the reality presented 11

II. The Petitioner's Right to Freely Associate, as Guaranteed by the First and Fourteenth Amendments, has been Violated............

III. The Limited Liability Companies in the Instant Case are not Securities as defined by Arizona and Federal Securities Laws................ 18

IV. The Due Process, Freedom to Associate and Securities Arguments Found Above Present Properly Stated Federal Questions for this Court to Review.......................... 26

CONCLUSION 27

TABLE OF AUTHORITIES

Page

FEDERAL CASES

Abedini v. INS, 971 F.2d 188 (9th Cir. 1992)	16
Arasco, Inc. v. Kadish, 490 U.S. 605 (1989)	26
Barber v. United States, 711 F.2d 128 (9th Cir. 1983)	16, 17
Beistline v. City, 256 F.2d 421 (9th Cir. 1958)	27
Berroteran-Melendez v. INS, 955 F.2d 1251 (9th Cir. 1988)	16
Broadnax v. State, 219 U.S. 285 (1911)	27, 28
Caldwell v. Sioux Falls Stock Yards Co., 242 U.S. 559 (1917)	28
Carr v. O'Leary, No. 89 C 9218, 1995 WL 417602 (N.D. Ill. 1995)	11
Cudras v. INS, 910 F.2d 567 (9th Cir. 1985)	11
Dardeau v. West Orange Grove, 43 F. Supp. 2d 722 (E.D. Tex. 1999)	27
Davis v. Singletary, 853 F. Supp. 1492 (M.D. Fla. 1994)	16
Edenfield v. Fane, 507 U.S. 761 (1993)	17
Hall v. Geiger-Jones Co., 242 U.S. 539 (1917)	12, 28
Hayes v. Reed, Civil Action No. 96-4941, 1997 WL 125742 (E.D. Pa. Mar. 13, 1997)	12, 26
Hayes v. Reed, No. CIV A. 96-4941, 1997 WL 700499 (E.D. Pa. Oct. 29, 1997)	12
Hill v. Marston, 13 F.3d 1548 (11th Cir. 1994)	27
Holden v. Hagopian, 885 F.2d 1449 (1989)	*passim*

TABLE OF AUTHORITIES – Continued

Page

Hunter v. City, 842 F. Supp. 1460 (M.D. Ga. 1994) 12

Jim Young Dev. Corp. v. Highway Comm'n, 56 F.R.D. 38 (W.D. Mo. 1971) 26

Mathews v. Eldridge, 424 U.S. 319 (1976)............ 12

Merrick v. N.W. Halsey & Co., 242 U.S. 568 (1917) 27

NAACP v. Alabama, 357 U.S. 449 (1958) 17

Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc., 840 F.2d 236 (1988) 23

Roberts v. United States Jaycees, 468 U.S. 609 (1984) 17

Sarvia-Quintilla v. INS, 767 F.2d 1387 (9th Cir. 1985)... 12

SEC v. W.J. Howey Co., 328 U.S. 293 (1946)......... 19

Tcherepin v. Knight, 389 U.S. 332 (1967)............. 19

United Housing Foundation v. Forman, 421 U.S. 837 (1985)....................................... 21

Wagner v. Memphis, 971 F. Supp. 308 (W.D. Tenn. 1997)...................................11, 14, 28

Wells Fargo Armored Svc. Corp. v. Public Svc. Comm'n, 547 F.2d 938 (5th Cir. 1977)..........11, 12

Williamson v. Tucker, 645 F.2d 404 (5th Cir. 1981)...*passim*

Winthrow v. Larkin, 421 U.S. 35 (1975)...........11, 16

Wright v. Coughlin, 31 F. Supp. 2d 301 (W.D.N.Y. 1998).......................................12, 16

STATE CASES

Arizona State Board of Medical Examiners v. Clark, 398 P.2d 908 (1965) 15

Berenter v. Gallinger, 839 P.2d 1120 (Ariz.App. Div. 1992) 14

Daggett v. Jackie Fine Arts, Inc., 152 Ariz. 559, 733 P.2d 1142 (Ariz.App. 1987) 19

Greenfield v. Cheek, 122 Ariz. 70, 593 P.2d 293 (Ariz.App. 1978), *Aff'd,* 122 Ariz. 57, 593 P.2d 280 (1979) 19

Havasu Heights Ranch & Dev. Corp. v. Desert Valley Wood Prod., Inc., 807 P.2d 1119 (Ariz.App. 1991) 14

Hobson v. Twentieth Century Fox Film Corp., 223 P.2d 399 (Ariz. 1950) 15

Hunter v. Warner Robins, 842 F. Supp. 1460 (M.D. Ga. 1994) 26

In re Gray's Estate, 211 P.2d 815 (Ariz. 1949) 15

In Re Nutek Information Sys., Inc., No. S-3046-I, 1996 WL 494745 (Ariz. Corp. Comm'n Aug. 22, 1996) 1

King v. Orr, 125 P.2d 699 (Ariz. 1942) 15

Nutek Information Sys., Inc. v. Arizona Corp. Comm'n, 977 P.2d 826, Blue Sky L. Rep. ¶ 74,173, 281 Ariz. Adv. Rep. 34 (Ariz. Ct. App. 1998) 1

Nutek Information Sys., Inc. v. Arizona Corp. Comm'n, No. CV-98-0548-PR (Ariz. May 25, 1999) 1

TABLE OF AUTHORITIES – Continued

Page

Nutek Information Sys., Inc. v. Arizona Corp. Comm'n, No. CV 96-20499 (Ariz. Super. Ct. 1997) 1

Ratley v. Industrial Comm'n, 248 P.2d 997 (Ariz. 1952) 15

Rose v. Dubras, 128 Ariz. 209, 624 P.2d 887 (1981) 19

Schade v. Retirement System, 510 P.2d 32 (Ariz. 1973) 15

Schmitz v. Arizona Board of Dental Examiners, 684 P.2d 918 (Ariz. App. Div. 1984) 10, 15

CONSTITUTION

U.S. Const. amend. I 17

U.S. Const. amend. XIV, § 1 . . . . . 11, 17

FEDERAL STATUTES AND REGULATIONS

Securities Act of 1933, 15 U.S.C. §§ 77a *et seq.* 18

Securities Exchange Act of 1934, 15 U.S.C. §§ 78a et seq. 19

28 U.S.C. § 1257 (1999) 1

28 U.S.C. § 1331 (1999) 26

47 C.F.R. Part 90, Subpart T, 90 C.F.R. 701, *et seq.* 4

STATE STATUTES

A.R.S. § 44-1801(22) 18

Texas Limited Liability Act, Tex. Rev. Civ. Ann., art. 1528n (Vernon (1992) 2

TABLE OF AUTHORITIES – Continued

Page

OTHER AUTHORITIES

Bromberg & Ribstien, *Partnerships*, Little Brown & Co., Ch. 6.06 (1998) 19

LARRY RIBSTEIN, RIBSTEIN AND KEATING ON LIMITED LIABILITY COMPANIES, VOL. I (July 1993) 18

Mark A. Sargent, Are Limited Liability Company Interests Securities?, 19 Pepperdine Law Review 1069 (1992) 18

CITATIONS TO LOWER COURTS' OPINIONS

In Re Nutek Information Sys., Inc., No. S-3046-I, 1996 WL 494745 (Ariz. Corp. Comm'n Aug. 22, 1996), where judgement was rendered against the Petitioners with regard to whether a membership in a Limited Liability Company constitutes a security interest.

Nutek Information Sys., Inc. v. Arizona Corp. Comm'n, No. CV 96-20499 (Ariz. Super. Ct. 1997), where, based upon deference to the fact finder, the previous administrative decision was affirmed in a *de novo* review.

Nutek Information Sys., Inc. v. Arizona Corp. Comm'n, 977 P.2d 826, Blue Sky L. Rep. ¶ 74,173, 281 Ariz. Adv. Rep. 34 (Ariz. Ct. App. 1998), where, based upon the facts found by the Arizona Corporations Commission, the previous administrative decision was upheld.

Nutek Information Sys., Inc. v. Arizona Corp. Comm'n, No. CV-98-0548-PR (Ariz. May 25, 1999), where review by the Supreme Court of Arizona was denied.

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JURISDICTION

Petitioner respectfully prays that a Writ of Certiorari issue to review the opinion of the Arizona Court of Appeals, 977 P.2d 826, and the Supreme Court of Arizona's decision on May 25, 1999, denying review of same. This Court has jurisdiction to consider this Petition arising from a final judgement or decree of the Supreme Court of Arizona, the highest court of the State of Arizona, pursuant to 28 U.S.C. § 1257 (1999), which states that the Supreme Court may take jurisdiction on federal questions from review, or denial thereof, by the highest state court.

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STATEMENT OF THE CASE[1]

During the winter of 1993 to 1994, various persons known to each other, some possessing Federal Communications Commission ("FCC") licenses to build and operate 220-222 Megahertz ("220 MHz") dispatch radio frequencies, others being investors in the telecommunications business, and still others having technological know-how came together through happenstance and built out such operating systems. As the participants wanted to operate their enterprises as partnerships, each of the systems first took the form of partnerships and later took the form of a limited liability company ("LLC"), which its then participating members took to be partnerships with the advantage of individual members liability limited to paid in capital. Such was the statutory language of the Texas enabling statute under which each LLC was organized. Texas Limited Liability Act, Tex. Rev. Civ. Ann., art. 1528n (Vernon 1992). Some of the participants LLC members were tele-marketers. As the initial build outs went well they sought to find other persons to join together and do likewise. Common to all the ventures were the Petitioners, performing construction, day to day management acts, and administrative office functioning. Eventually, some forty (40) such companies came into existence.

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[1] A full digest of the facts adduced at the Hearing can be found in the Proposed Findings of Fact in the Appendix to this Petition on page 122.

The 220 MHz frequency was newly developed by the FCC. Each system had the capability to be inter-communicative. As the months went on the members of the various systems (not Petitioners) began conceiving of the idea that their business would be advantaged if they entered into cooperative agreements to permit customers of one system to communicate with customers using other communications systems, a well deployed concept in the telecommunications industry known as "roaming." The formation of reciprocating roaming agreements is common in the communications industry and allows a user of one system's facilities to communicate while in another system's geographical area in which the 220 MHz band is being used. The "proposed" system became referenced as the "Western Regional Network," (the "WRN"). It never came into existence, it was merely an idea being discussed amongst the various members of the various LLCs. (The individual systems were in operation at all times relevant to these proceedings and continue in operation to this date.)

Each of the forty LLCs were organized by SMR Advisory and one partner (member-to-be[2]) who was either from the public, an affiliate, or 220 MHz license holder. The organizational participants then entered into the standard initial agreements to enable and start the build out of the FCC awarded and regulated license, *i.e.*, the radio dispatch facility. 47 C.F.R., Part 90, Subpart T, 90 C.F.R. 701, *et seq*. Thereupon the original member/partners sought out additional member/partners to participate in the build out and provide additional capitalization. The Membership Summary, a prospectus like document describing the LLCs, referred to these organizational members as Class A members. The agreements, all of which were attached to the Membership Summary, committed SMR Advisory Group, LLC ("SMR Advisory") to perform construction and day to day management of the system pursuant to a standard, FCC accepted, industry agreement. In consideration for performing these duties, SMR Advisory received an eight percent (8%) equity ownership interest in the LLC. The license holder, who was obligated to transfer his license to the LLC, but only after completion of the license build out, as required by the regulations under the Federal Communications Act, received a twenty percent (20%) interest in the LLC. During the Class A period of the LLC's existence, the LLC was committed to perform pursuant to the *advice and consent* of the existing "prospective" Class B member/partners, the LLC members who joined the LLC after its organization. Upon completion of the operating 220 MHz system, the Class A membership ceased to exist and the members of the public who were accepted by the organizing member/partners in the LLC's business, the Class B members, had complete control over the LLC. (S. 47, 48, 52, 66, 91-94, 121-127 and 130; Tr. 270, Ls. 3-19, Tr. 133, Tr. 255, Ls. 10-11, Tr. 258, Ls. 8-14, Tr. 336, Ls. 20-25, Tr. 535, Ls. 9-15, Tr. 286, Ls. 22-25, Tr. 465, Ls. 19-26 to 466, L.1.)

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[2] Participants in a partnership are referred to as partners. Participants in an LLC are called, "members."

During the construction phase the Class B members were asked to make the major decisions to build out the system and suggest changes to the business plan or membership regulations. Each LLC received proxies for more than a dozen proposals to vote upon. Some had to make special decisions on unique equipment requirements, given peculiarities of the location of their dispatch system. Each Class B member had the right to request the full refund of his/her/its reservation monies during the construction period, for any reason or no reason whatsoever. Once construction was completed each member was given an LLC Membership Summary, providing a description of all aspects of the LLCs' industry, and the instant buildout, and thereupon had a final seven (7) days to request a refund.[3] At the time of the hearing, refund requests in excess of three hundred fifty thousand dollars ($350,000) had been made and paid out to prospective members. (S. 34, 37, 38, 46, 47, 55, 62, 64, 66, 91-94; Tr. 129-130, Tr. 290-292, Tr. 294-295, Tr. 833-835, Ls. 1-3.)

At the hearing the Arizona Corporations Commission (the "Commission") presented two (2) investor witnesses, Messrs. Jesse Simmons, who was an active member/

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[3] The Membership Summary risks were in bold type and prominent, covered some seventeen topics, over an approximate ten pages. (S. 47, 66, 91-94; Tr. 133, Tr. 270, Ls. 3-19, Tr. 290-292 and 294-295, Tr. 833 to 835, Ls. 1-3, Tr. 290-292 and 294-295). Thus, the Membership Summary, among other things, amounted to a competent disclosure of the risks incidental to entering into the membership/partnership. One might ask, as the Hearing Officer did during the hearing to the prosecuting attorneys "[w]hat more can they do to warn Mr. Six-Pack" (Tr. 833 to 835, Ls. 1-3; particularly, 835, Ls. 2-3).

partner but who upon receiving his Membership Summary opted to rescind his participation and received back his full reservation fee, and LLC member/partner Donald Pershing. Mr. Simmons is a retired electrical equipment manufacturer, held a doctorate in philosophy, was a registered securities broker and had investments in stocks, bonds, commodities, mutual funds and limited partnerships. Mr. Pershing owns his own business and makes instruments to measure solar radiation. He holds a degree in physics from Arizona State University. He has invested in stocks, bonds, mutual funds, oil leasing, and real estate. The Appellants presented LLC members Messrs. Mark A. Lidke and Prof. William Fey. Mr. Lidke is a reliability engineer at Motorola, Products Sector, where he conducts life testing on computer chips. He holds one master's degree in chemical engineering from California Poly, Ponoma and a second master's degree in electrical engineering from the University of Arizona. Willard Fey is an associate professor at Georgia Tech where he teaches System Dynamics, a method for analyzing investments. He graduated from MIT's Sloan School where he studied how corporations and governments work. He consults with corporations about business management. (Tr. 71, Ls. 1-10, Tr. 124, Ls. 20-23, Tr. 71, Ls. 20-25, Tr. 72, L.10; S. 53, 66, 91; Tr. 174, Ls. 23-25, Tr. 248, Tr. 275.)

Each investor witness testified that they had discussed the prospective investment extensively with their membership recruiters. The discussions included, but were not limited to, the business plan, risks incidental thereto and the duties of each of the members concerning their expected participation in the business's and LLC's management.[4] Each also stated that they understood and/or had explained to them the difference between this investment and a security. Each participated actively by partaking in proxy votes and attending various LLC meetings by telephone or in person. At least three of the investor witnesses, at one time or another, took an active role in day to day affairs as well as management functions. (S. 37, 38, 41, 40, 48, 49, Tr. 72, Ls. 10-25, Tr. 75, Ls. 17-18, Tr. 73, Tr. 77, Ls. 10-15, Tr. 78, Ls. 5-17, Tr. 80, Ls. 18-22, Tr. 136-137, Tr. 145, Ls. 16-23, Tr. 147, Tr. 148, Ls. 1-3; S. 67, R. 2 and 3, Tr. 250, Tr. 255-258, Ls. 1-7. Tr. 276, Tr. 260, Tr. 261, Ls. 1-10, Tr. 267, Ls. 11-25 through Tr. 268, Tr. 277, Ls. 8-13, and 19-28 to 278, Ls. 1-6, Tr. 289, Tr. 292, Ls. 20-25 to 293, Ls. 1-8; R. 7, Tr. 466, Tr. 468-470, Tr. 513, Ls. 20-22, Tr. 477, Ls. 17-25 to 478, Ls. 17-21; R. 9; *particularly memorandum of February 27, 1995, Tr. 528 to 529, L. 1.*)

Each gave testimony that they had access to all LLC information, that they believed they individually, and as a whole, had influence in the exercise of their membership rights,[5] that if it became necessary both Aks Daks and SMR Advisory could be replaced because there existed many other bookkeeping and construction and maintenance contractees in the industry. (S. 37, 38, 41, 49, Tr.

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[4] There is a distinction between operation of the LLC, the membership, and operation of the company's business, the dispatch radio enterprise, a distinction that the authorities below ignored.

[5] Mr. Lidke told the story of what occurred at an LLC meeting in Sacramento, California. Mr. Koenigsberg offered to be the president of each of the LLCs. The members rejected his nomination. (Tr. 466 through 467.)

90-91, Tr. 95, Tr. 136-137, Tr. 145, Ls. 16-23, Tr. 147-148, Ls. 1-3, Tr. 121, Ls. 6-15; Tr. 260, Ls. 22-25, Tr. 261, Ls. 1-10, Tr. 267, Ls. 20-25 to 268, Ls. 1-6, Tr. 277, Ls. 8-13, Tr. 277, Ls. 19-25 to 278, Ls. 1-6, Tr. 289, Tr. 2892, Ls. 20-25 to 293, Ls. 1-8; R. 7, 9, Tr. 466, Tr. 468-470, Tr. 513, Ls. 20-22, Tr. 466-467, Tr. 471, Ls. 22-25, Tr. 475, Ls. 5-8, Tr. 477, Ls. 17-25 to 478, Ls. 1-21, Tr. 482, Ls. 8-11, Tr. 485, Ls. 1-6, Tr. 491; Tr. 529, Ls. 16-25, Tr. 533, Ls. 4-14, Tr. 538, Ls. 18-24, Tr. 546, Ls. 1-10, Tr. 557, Tr. 560.)

The LLCs developed an Intranet or Visual Response Unit ("VRU") to keep the lines of communication open. The VRU enabled discussion between member/partners before voting and added an efficient way for numerous member/partners to communicate as would be required in any partnership.

Each member witness testified that every LLC was maintained as a separate entity, not as an aspect of the Western Regional Network ("WRN"), and that the WRN was no more than a concept being considered by the members of the various LLCs. (S. 8, 67, R. 2, 3, 6, 8, 9, Tr. 255-258, Ls. 1-7, Tr. 265 to 266, Ls. 11-13 through 267, Ls. 1-8, Tr. 276, Tr. 463-464, Ls. 1-5, Tr. 466 through 467, Tr. 470-476, Tr. 471, Ls. 22-25, Tr. 475, Ls. 5-8, Tr. 486, Tr. 539, Ls. 14-23, Tr. 540, Ls. 1-3, Tr. 542, Tr. 549 through 557, Tr. 1106-1128, Tr. 607, Ls. 17-25 through 609, Ls. 1-6, Tr. 617, Ls 21-25 through 618, Ls. 1-5, Tr. 622, Tr. 641, Tr. 656, Ls.11-25 to 657, Ls. 1-23, Tr. 1095, Ls. 16-25 to 1099, Ls. 1-14.)

Finally, Prof. Fey provided special insight and understanding as to how the business came into being and was meant to operate.

> And as I talked to him [Mr. Koenigsberg], I discovered that he had the kind of management philosophy that I was really looking for as an investor because since I had a management background and was a consultant for corporations, it was my desire to participate as much as I could in the investments that I was making. I didn't want to just invest in something that somebody else was going to manage. (Tr. 530).

Prof. Fey testified that, from their first formulations, in the early days of February, 1994, the LLCs were individual enterprises of people that negotiated with 220 MHz license holders to build out those license holders' systems. He then told the Commission that as the success of the initial LLC build outs spread Mr. Koenigsberg became the center of communications. Next, other people who heard about his first build out contacted Mr. Koenigsberg concerning their building out other 220 MHz dispatch communication systems. As the numbers increased during the winter, spring and summer of 1994, SMR Advisory, and the various partners, decided to convert the partnerships into LLCs as an appropriate form of business enterprise. The Commission was not able to bring one member/partner that was unhappy with his or her investment and participation in the LLC. (S. 47, 66, 91-94, Tr. 151, Tr. 265, Ls. 23-25 to 266, Ls. 1-10, Tr. 539, Ls. 14-23, Tr. 540, Ls. 1-13, Tr. 556.)

The Commission ignored all of the above uncontroverted testimony and instead relied, exclusively on Dale Hatfield's testimony, a non-participant in the business entities and the Commission's self haled expert. However, Mr. Hatfield was proven to be biased against the Petitioners in the form of an adverse business interest, he was the member of the Board of Directors of a competing radio dispatch company. He was also untruthful and contradictory in his testimony in that only a few months before his testimony in this case Mr. Hatfield had taken the directly opposite position as to his testimony in an article authored on the viability of the 220 MHz frequency. He was never specifically found to be credible by the Commission. (R. 18).

In Petitioner's Proposed Findings of Fact to the Commission, the Petitioner justified every proposed finding of fact with a citation to the record. (*See* Appendix page 122 attached hereto, Petitioner's Findings of Fact.) However, the Commission, in its official findings of fact, cited to the record under five times. This is because the Commission's version of the facts cannot be found in the record.

At the Arizona Superior Court and Arizona Court of Appeals level, the state opted to give blind deference to the facts which the Commission found, notwithstanding their dubious character. Arizona law, however, requires that judicial review of administrative decisions occur *de novo*. *E.g., Schmitz v. Arizona Board of Dental Examiners*, 684 P.2d 918, 921 (Ariz. App. Div. 1984). But, because of the incantation of deference which the courts below observed, the concocted facts of the Commission were never examined against the record.

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REASONS FOR GRANTING THE WRIT

I. The Petitioner's Due Process Rights have been Violated by the clearly erroneous, arbitrary and illegal actions of the Commission, and the Arizona courts' subsequent refusal to fully review such actions in its depiction of the hearing evidence which was contrary to the reality presented:

Due process requires a hearing, but a hearing is meaningless if the outcome of the hearing is predetermined and the law is neither stated correctly nor applied correctly. *See, Wagner v. Memphis,* 971 F. Supp. 308, 318 (W.D. Tenn. 1997) (holding that a hearing with a predetermined outcome is always meaningless). The Due Process Clause of the Fourteenth Amendment provides that "No State shall . . . deprive any person of life, liberty, or property, without due process of law." U.S. Const. amend. XIV, § 1. "[T]he touchstone of due process is the protection of the individual against arbitrary action of government." *Carr v. O'Leary,* No. 89 C 9218, 1995 WL 417602, at *6 (N.D. Ill. 1995). At a minimum, due process requires a full and fair trial and a fair tribunal, even a possibility of unfairness must be prevented. *Winthrow v. Larkin,* 421 U.S. 35, 37 (1975); *Cudras v. INS,* 910 F.2d 567, 573 (9th Cir. 1985).

In order to state a claim based on the denial of due process, one must show that a protected property interest[6] has been deprived without due process of law. *Wells*

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[6] The protected property interest herein involved are the 220 MHz FCC issued Radio station licenses. They are a protected property interest because privileges, licenses, certificates, and franchises of any kind are protected property

Fargo Armored Svc. Corp. v. Public Svc. Comm'n, 547 F.2d 938, 940 (5th Cir. 1977); *Wright v. Coughlin*, 31 F. Supp. 2d 301, 310 (W.D.N.Y. 1998). In addition, due process requires the consideration of the private interest effected, the risk of erroneous deprivation of such interest, and the government's interest. *See Mathews v. Eldridge*, 424 U.S. 319 (1976); *Hayes v. Reed*, No. CIV A. 96-4941, 1997 WL 700499, at *5 (E.D. Pa. Oct. 29, 1997); *Hayes v. Reed*, Civil Action No. 96-4941, 199 WL 125742, at *5 (E.D. Pa. Mar. 13, 1997). It is irrelevant that the purpose of the action was correct, where the manner in which the case was decided was incorrect, the case will not pass a due process review. *Hall v. Geiger-Jones Co.*, 242 U.S. 539, 551 (1917).

A full and fair trial is accomplished when the case is evaluated on its own merits and a determination is made as to whether there is factual support and concrete credible evidence that supports one side or another. *See Sarvia-Quintilla v. INS*, 767 F.2d 1387, 1392 (9th Cir. 1985). Here, the trier of fact based its entire opinion on the

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interests under due process. *Wells Fargo*, 547 F.2d at 941; *Hayes*, 1997 WL 700499 at *5. So long as there is a legitimate claim of entitlement to something it can be considered a protected property right. *Hunter v. City*, 842 F. Supp. 1460, 1466 (M.D. Ga. 1994); *Wells Fargo*, 547 F.2d at 940. A person must be "deprived" of his or her protected property interest as soon as any indirect injury effectively renders a protected property interest valueless. *Id.* at 941. Here, the Commission's act in creating liability for the Petitioners under Arizona securities law has rendered the radio station licenses valueless, by denying the Petitioners' access to capital markets via their partnership like entities, LLCs.

testimony of the one witness in the case that it specifically did not and could not find to be credible, Dale Hatfield.

When the Commission Chairman asked the Hearing Officer if Mr. Hatfield was credible, the Hearing Officer responded, "[h]e certainly seemed to know telecommunications, or communications in general, or what was involved." Transcript of August 20, 1996 Working Session. Page 19, Ls. 8-14. Yet, the Commission relied on Mr. Hatfield for their entire case of fraud and deeming the LLCs securities *even though his testimony was in opposition to all of the member/participants' testimony*. It is a denial of due process to hire an alleged expert witness to say exactly what you want him to say and then base your entire opinion on his non-credible testimony.

Notwithstanding that Mr. Hatfield was not found to be credible the Arizona Court of Appeals stated "we cannot review the evidence or reassess the credibility of the witnesses." 977 P.2d 835. This is tantamount to a double denial of due process. The only way in which due process can be afforded to the Petitioners is by a full review of the record. It is impossible to believe that anybody has reviewed the record because the evidence of the *participating* members is uncontroverted (both the Commission's and the Petitioner's.) Yet, to overcome the testimony of the participating members, the Commission and the reviewing courts, without citation, state facts and law which are not supported by the record. Therefore, it is reasonable to conclude the record has not been utilized in deciding the various levels of this case, other than the sole reliance by the Commission on Mr. Hatfield's concoctions.

A hearing is meaningless if the outcome of the hearing is predetermined. *Wagner*, 971 F. Supp. at 318. Because the Commission's decision was made up irregardless of the hearing evidence, the hearing did not fulfill its purpose in terms of due process. *See id.* This means that the hearing was a sham and should not have been deferred to by the Arizona courts.

In *Berenter v. Gallinger*, 839 P.2d 1120 (Ariz.App. 1992), the court stated the standard of review for the Arizona Superior Courts when determining whether an administrative decision is proper, under the Administrative Review Act, A.R.S. § 12-901 *et seq.*

> When an administrative decision is appealed to the superior court, the superior court decides only whether the administrative decision was illegal, arbitrary, capricous, or involved an abuse of discretion. *Havasu Heights Ranch & Dev. Corp. v. Desert Valley Wood Prod., Inc.*, 807 P.2d 1119, 1122 (Ariz. App. Div. 1991).

Havasu Heights Ranch, 807 P.2d at 1123.

The superior court must make its determination by searching the entire record to find if the proposed findings of fact or the Commission's holdings of fact are supported by the record. In the instant case, this could not have happened in the superior court because the opinion does not reflect even a remedial knowledge of the facts. Rather, the superior court opinion reflects only a cursory reading of the briefs submitted by both sides and a lackluster understanding of the law.

> When considering whether there is substantial evidence to support the agency's decision, the superior court must review the "entire record."

> A.R.S. *See Arizona State Board of Medical Examiners v. Clark*, 398 P.2d 908 (1965). The "entire record" is defined as all evidence recieved and considered including transcript. A.R.S. §§ 41-1009(E)(2), (F).

Schmitz v. Board of Dental Examiners, 684 P.2d 918, 921 (Ariz. App. Div. 1984); *see also Schade v. Retirement System*, 510 P.2d 32, 45 (Ariz. 1973) ("We can find nothing in the record to reasonably support the findings of the Board"). And finally, the Supreme Court of Arizona, quoting its earlier ruling in *King v. Orr*, 125 P.2d 699, 702 (Ariz. 1942), stated, "Of course, if there were no evidence in the record to support the [Commission's] findings, it would be the duty of the court to set them aside." *Hobson v. Twentieth Century Fax Film Corp.*, 223 P.2d 399 (Ariz. 1950). Anything less than setting aside unsupported conclusions of fact adds up to a denial of due process of law. As stated by the Supreme Court of Arizona:

> [t]he triar of facts may not arbitrarily reject such uncontradicted evidence when nothing intrinsic in the evidence itself or extrinsic in the circumstances casts suspicion thereupon. Further, where an interested witness is corroborated by a disinterested witness, a rejection of that evidence amounts to *arbitrary action* by the court.

Ratley v. Industrial Comm'n, 248 P.2d 997 (Ariz. 1952) (citing *In re Gray's Estate*, 211 P.2d 815 (Ariz. 1949).

Here, the interested witnesses are the Commission's participating member witnesses and the disinterested witnesses are the Petitioner's participating member witnesses.

The decision maker in any case must base its decision on law and facts, and is not permitted to knowingly rely on the testimony of a non-credible witness under the penalty of a due process violation. *See Davis v. Singletary,* 853 F. Supp. 1492, 1567 (M.D. Fla. 1994).

Due process requires that all determination made by hearing officers and administrative agencies, in an adjudicative role, be based upon credible evidence. *Wright,* 31 F. Supp. at 326. Here, the administrative agency based its decision upon a witness that was found not to be credible, Dale Hatfield and whose testimony contradicts the actual participating members' testimony. For example, the Commission's and the Arizona Court of Appeal's descriptions of fraud traced Mr. Hatfield's testimony, contrary to all of the participant witnesses' testimony. This honorable Court has the authority and the duty to determine if there is evidence on the record sufficient to support the Commission's findings. *See Wright,* 31 F. Supp. at 329.

Federal courts have the authority to review administrative agencies' findings for substantial evidence and substantial reason. *Winthrow,* 421 U.S. at 36; *Abedini v. INS,* 971 F.2d 188, 190 (9th Cir. 1992); *Berroteran-Melendez v. INS,* 955 F.2d 1251, 1255 (9th Cir. 1988). Courts must review the fact finding body in order to insure the integrity of the fact finding process. *Barber v. United States,* 711 F.2d 128, 131 (9th Cir. 1983). A close examination of the record, which Petitioner believes has never happened, indicates that there is not one shred of evidence that supports the legal and factual findings of the Commission. This policy of blind deference will erode the due process protections upon which this nation is built. This incantation of deference to the trier of fact is preventing the proper administration of justice. *Id.*

II. The Petitioner's Right to Freely Associate, as Guaranteed by the First and Fourteenth Amendments, has been Violated:

By restricting the Petitioner's right to join together and associate with others seeking to build the nation's largest 220 MHz network, the Commission unduly burdens the Petitioner's right to freely and lawfully associate, as guaranteed by the United States Constitution. *See* U.S. Const. amend I, XIV. The free speech clause of the First Amendment encompasses protection of the right to associate with others "in pursuit of a wide variety of political, social, [and] economic . . . ends." *Roberts v. United States Jaycees*, 468 U.S. 609, 622 (1984). Personal solicitation is commercial speech which is protected by the First Amendment. *Edenfield v. Fane*, 507 U.S. 761, 765-766 (1993). Thus, a communication that does nothing more than suggest a commercial relationship is entitled to First Amendment Protection. *Id.* at 1798.

State action that chills this freedom to associate, including association for economic purposes, is subject to strict judicial scrutiny. *NAACP v. Alabama*, 357 U.S. 449, 460 (1958). Strict scrutiny requires that the state have a compelling interest and that there is no less restrictive means of achieving this interest. *Roberts*, 468 U.S. at 623.

Here, if the investments really are securities, there is a compelling governmental interest of protecting the public. However, because the interests in LLCs offered by

Petitioners are not securities, there is no compelling interest. In the instant case, all of the investors were able to participate in the business venture and communicate with each other. The state's interest is in protecting those investors that cannot participate in the functioning of their investment, not those who are involved.

III. The LLCs in the Instant Case are not Securities as defined by Arizona and Federal Securities Laws:

Whether the instant LLC[7] transactions (or the WRN) constitute a security and whether the Commission may claim jurisdiction over the Petitioners, depends upon whether such transactions constitute an investment contract. The statutory definition of a security found at A.R.S. § 44-1801(22) does not include LLCs, as it does not include partnerships. Thus, it must be determined whether it is captured as an "investment contract," a catchall term found in the statute. The Arizona statute is substantially the same definition found in the Securities Act of 1933, 15 U.S.C. §§ 77a *et seq.* and the Securities

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[7] An LLC may be generally defined as an unincorporated association, which has general partnership characteristics and some corporate, such as liability limited to paid in capital. *See generally,* LARRY RIBSTEIN, RIBSTEIN AND KEATING ON LIMITED LIABILITY COMPANIES, Vol. I (July 1993); Mark A. Sargent, *Are Limited Liability Company Interests Securities?*, 19 Pepperdine Law Review 1069 (1992) (concluding that interests therein are not securities under most circumstances). Each of the LLCs subject to this proceeding is a member managed, Texas LLC. An LLC is a contractual arrangement among the members, and the principal of freedom of contract should be applied to the relationship among the owners. See, *id.*

Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.* Arizona looks to federal interpretations of securities law and in particular, investment contract law for guidance. *Greenfield v. Cheek,* 593 P.2d 293, 296 (Ariz.App. 1978), *aff'd,* 593 P.2d 280 (1979); *Rose v. Dubras,* 624 P.2d 887, 889 (Ariz. 1981); *Daggett v. Jackie Fine Arts, Inc.,* 733 P.2d 1142, 1148 (Ariz.App. 1987). Whether an otherwise non listed financial transaction becomes a security is determined under federal law pursuant to the seminal case of *SEC v. W.J. Howey Co.,* 328 U.S. 293 (1946). There, the Supreme Court of the United States defined an "investment contract" as a "transaction . . . whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." Contrarily, general partners, are individually responsible for securing the information necessary from their partnership and other individual partners, that each may deem necessary to participate in the partnership or joint venture type transaction. Bromberg & Ribstien, *Partnerships,* Little Brown & Co., Ch. 6.06 (1998).

The purpose of the *Howey* test is to identify from the standpoint of 'economic reality' the circumstances in which participants in an investment transaction are likely to need the information provided by the securities laws. *Tcherepin v. Knight,* 389 U.S. 332 (1967). The so called "efforts of others prong" of the *Howey* test was refined where the transaction under analysis is a partnership, in another seminal case, *Williamson v. Tucker,* 645 F.2d 404 (5th Cir. 1981). In *Williamson,* the Court held that there is an "extremely difficult factual burden" to establish that a general partnership interest is a security. *Williamson,* 645 F.2d at 424. Specifically, the proponent of the presence of a security in a general partnership transaction must establish that (1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers. *Williamson*, 645 F.2d at 424.

In addition the *Williamson* court also stated, "[w]e must emphasize, however, that a reliance on others does not exist merely because the partners have chosen to hire another party to manage their investment." *Williamson*, 645 F.2d at 423. In reasoning out the logic behind their decision, the *Williamson* court emphasized the investor's expectations based on partnership law, would result in the investor expecting that they had such significant ownership rights, that a presumption exists that the investor is not buying a security. Specifically, the court said that:

> [A]lthough general partners and joint venturers may not individually have decisive control over major decisions, they do have the sort of influence which generally provides them with access to important information and protection against a dependence on others. Moreover, partnership powers are not in the nature of a nominal role in

> the enterprise which a seller of investment contracts would include in order to avoid the securities laws; on the contrary, one would expect such a promoter to insist on ultimate control over the investment venture. *An investor who is offered an interest in a general partnership or joint venture should be on notice, therefore, that his ownership rights are significant, and that the federal securities acts will not protect him from a mere failure to exercise his rights."* (Emphasis added.).

Williamson, 645 F.2d at 422.

Thus, the Court relied primarily on what an investor would expect based on the structure of the partnership relationship. *See, United Housing Foundation v. Forman*, 421 U.S. 837, 853-54 (1985).

At the time of the transactions at bar, the controlling Ninth Circuit Court of Appeals case concerning investment contract/partnership was *Holden v. Hagopian*, 885 F.2d 1449 (1989). *Holden*, thus, was the controlling Arizona law. The plaintiff/appellants therein claimed that Mr. Holden's horse breeder's efforts were essential elements to the success of the enterprise and that the various pre-arranged contracts took away many of their powers. The contracts and article of partnership powers in *Holden* were comparable to those in the instant case. The *Holden* court confronted the following argument:

> Finally, appellants cite the facts that Hagopian prearranged leases of mares and stallion seasons by the general partnership (i.e., the Mare Lease Agreements) before they invested, that he was the sole manager of the partnership.
>
> These allegations, however, merely show that appellants chose to be passive and did not

> actively utilize the legal powers afforded them by the partnership arrangement and, again, that Hagopian was an able manager. Appellants' failure to participate in the partnership's decisions and to obtain information regarding its operations may prove that they sat on their rights as general partners but it does not support the conclusion that Hagopian is uniquely qualified to manage KTA within the meaning of Williamson's third prong.

Holden, 885 F.2d at 1122-1123.

And finally the court concluded:

> Appellants argue that Hagopian is not replaceable because the general partners themselves do not have the necessary expertise or equipment to raise horses. Appellants' inquiry, however, is too narrow. Under this part of Williamson, investors must show that "there is no reasonable replacement" for the manager. Williamson, 645 F.2d at 423. A showing that the general partners do not possess the skills or abilities required to fill the manager's shoes simply is insufficient.

Holden, 885 F.2d at 1122.

The Arizona Court of Appeals, as did the Commission, reverses the second *Williamson* factor, which states, "the partner or venturer is so inexperienced and unknowledgeable *in business affairs* that he is incapable of intelligently exercising his partnership or venture power." (Emphasis added). The court of appeal's use of *Williamson* would lead to an outrageous result. For example, under the Arizona Court of Appeal's rule, a maitre d', a financier, and a chef come together to form a restaurant; such operation would be considered a security because the maitre d' and the financier do not have the technical knowledge that the chef possesses. This is an absurdity which emasculates the concept of a partnership.

Further, Justice Powell in *Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc.*, 840 F.2d 236 (1988), perhaps the most important case relating to the transactions with which we are dealing, stated:

> If and to the extent that Williamson and other cases may be read to require a court to look to the actual knowledge and business expertise of each partner in order to assess his or her individual ability intelligently to exercise the power of a general partner, we do not agree. Such an inquiry would undercut the strong presumption that an interest in a general partnership is not a security. It also would unduly broaden the scope of the Supreme Court's instruction that courts must examine the economic reality of partnership interests.

Rivanna, 840 F.2d n. 7.

Holden is directly comparable to the case before us, was cited in the briefs below, but strangely, was not cited by the Commission, nor the Arizona Court of Appeals even though it was controlling law at the time of the transaction in the case at bar. *Holden*'s precedence requires a reversal of the Commission's Order. *Holden* emphasized that a determination of whether a partnership is a security is made by looking at the economic reality of the agreement, and not the partner's individual lack of expertise. (Although, at bar, all the investor witnesses had technical as well as business acumen.) The affirmation of the Commission's order is based upon an inaccurate statement of the law.

The Misstatement of the law below went even further. In its written August 22, 1996 Opinion and Order, the Commission, and the Arizona Court of Appeals in affirming the opinion, although alleging to be following *Williamson* misstates and misapplies the actual rule stated in the case. The first section of the three criteria rule in *Williamson*, states, a partnership can become a security if, "an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership." However, the Commission restated the rule as, "an agreement among the parties which leaves investors with limited powers comparable to those of a limited partner." Then when applying its misstated rule in its analysis, the Commission further emasculates the *Williamson* holding in a manner to change the rule's import and grossly lower the standard for finding a security. The Commission misstates its own mis-characterized rule by making the criteria, simply, whether the management agreements, *limits the investors powers*.[8] (*See*, August 22, 1996 Opinion and Order of Commission, at page 12.) The Commission's version of the rule again creates another absurd standard, in that it holds a security to be created where a partnership enters into a contract giving away some quantum of its rights. For any contract to be valid, rights must be exchanged, i.e., consideration. Further, the Ninth Circuit held in *Holden*, the prevailing law at the time of the Petitioner's acts, contracting managerial services are not paramount to creating a security. The management contracts at bar are reasonable, permit the managers to perform day to day functions and require membership consent for major business transactions.

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[8] Thus, dropping *"comparable to those of a limited partner."*

The Commission's legal mis-statements continue, though. The second *Williamson* criteria evaluates whether, "the partner or venturer is so inexperienced and unknowledgeable *in business affairs* that he is incapable of intelligently exercising his partnership or venture powers. (*Emphasis added*). The Commission's August 22, 1996 Opinion and Order, at pages 12-13, drops the "*in business affairs*" concept and finds that their transactions violated this criteria because the business is scientifically technical, and without the Petitioners, the members could not function. This conclusion is reached notwithstanding the testimony of each witness that they could manage the business if they had to take over the day to day management.

Concerning the third *Williamson* factor, "the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers," the Commission finds, "[t]here is no question that SMR, ADC and Mr. Koenigsberg are indispensable to the investors in the LLCs because the investors therein are lacking real control due to contracting away the management of their investments." It was noted above, that although Arizona looks to federal law as guidance, which the Commission accepts, the Commission failed to cite the latest and most comparable case on the facts, *Holden*, which is contrary to the Commission's holding herein.

Holden, 885 F.2d at 1122-23. By affirming the Commission, which never got the law correct, and completely ignoring the then prevailing case law on the subject, the Arizona Court of Appeals sought a result notwithstanding the law and the record of the case, an effective denial of due process. Where a state modifies a federal law which it relies upon, it must have an adequate state law grounds for doing so. *Arasco, Inc. v. Kadish*, 490 U.S. 605, 626 (1989).

IV. The Due Process, Freedom to Associate and Securities Arguments Found Above Present Properly Stated Federal Questions for this Court to Review:

The due process argument raise a properly stated federal question. A federal question arises under the constitution, laws, or treaties of the United States. 28 U.S.C. § 1331 (1999). Because Petitioner has established *supra* that a protected property right is herein involved, "the process due in abridging that right is governed by federal law." *Hunter v. Warner Robins*, 842 F. Supp. 1460, 1466 (M.D. Ga. 1994). The question of whether property was deprived in violation of due process is a federal question. *Jim Young Dev. Corp. v. Highway Comm'n*, 56 F.R.D. 38, 40-41 (W.D. Mo. 1971). In addition, where one states a due process claim, federal courts must reach all justiciable issues raised. *Hayes v. Reed*, Civil Action No. 96-4941, 1997 WL 125742, at *6 (E.D. Pa. Mar. 13, 1997). Here, Petitioner has stated a due process claim, has established a protectable property interest under due process, and has shown that such interest was deprived. Thus review by this honorable Court is proper.

The freedom to associate argument raises a properly stated federal question. Any general allegation of a constitutional issue is enough to raise a federal question. *Beistline v. City*, 256 F.2d 421, 425 (9th Cir. 1958). The freedom to associate under the First Amendment is a constitutional issue which was raised in this case but never decided upon. It is imperative that the Court reach this issue in order to assure that other citizen's rights to freely associate are not abridged by administrative agencies in the states.

The securities argument raises a properly stated federal question. Some disputed question of federal law is required for federal question jurisdiction. *Dardeau v. West Orange Grove*, 43 F. Supp. 2d 722, 725 (E.D. Tex. 1999). Where a state law claim necessarily turns on the construction of a federal law, federal question jurisdiction exists. *Hill v. Marston*, 13 F.3d 1548, 1549 (11th Cir. 1994). Arizona law specifically requires that all state securities statutes be interpreted in accordance with federal law. The fact that the corpus of the Arizona securities laws require analysis of federal law is sufficient to induce federal question jurisdiction. *See id.* at 1550.

◆

CONCLUSION

Where the judgement of a state administrative body is palpably arbitrary, as has been demonstrated in this case, interference by the courts is justified. *Merrick v. N.W. Halsey & Co.*, 242 U.S. 568, 686 (1917). The federal courts have a duty to see that the state does not arbitrarily infringe upon the rights of citizens. *Broadnax v.*

State, 219 U.S. 285, 292-93 (1911). The Supreme Court of the United States has the right to prevent further state securities enforcement which is repugnant to the constitution. *Caldwell v. Sioux Falls Stock Yards Co.,* 242 U.S. 559 (1917). Adverse decisions by commissions are reviewable by higher courts, and these courts must review administrative decisions without being encumbered by the incantation of deference to the trier of fact. *See Hall v. Geiger-Jones Co.,* 242 U.S. 539, 553-54 (1917).

The membership interest in LLCs herein discussed are not securities as defined by *Williamson, Holden,* and Arizona state securities law prevailing at the time of the transactions. The Petitioners have been denied their rights to freely associate and due process. This case must be reviewed for errors of law, fact, and for due process violations. The Commission conducted a hearing for the sole purpose of giving lip service to the law and to avoid the appearance of impropriety. Sham hearings are meaningless and must not be allowed to stand. *Wagner,* 971 F. Supp. at 319.

Respectfully Submitted,

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BEFORE THE ARIZONA CORPORATION COMMISSION

RENZ D. JENNINGS
CHAIRMAN
MARCIA WEEKS
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

IN THE MATTER OF THE OFFERING OF SECURITIES BY:

NUTEK INFORMATION SYSTEMS, INC.
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AKS DAKS COMMUNICATION, INC.
SMR ADVISORY GROUP, L.C.
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DOCKET NO.
S-3046-I

DECISION NO.
59808

OPINION AND ORDER

DATES OF HEARING:	April 3, 4, 5, 6, 7, 10, 11, 12, and 13, 1995
PLACE OF HEARING:	Phoenix, Arizona
PRESIDING OFFICER:	Marc E. Stern
APPEARANCES:	LAW PRACTICE OF J.B. GROSSMAN, P.A. by Mr. J.B. Grossman and Mr. Kenneth J. Dunn, and ROSHKA HEYMAN & DeWULF P L C, By Mr. Paul J. Roshka, Jr., local

counsel, on behalf of A.K.s Daks Communications, Inc., SMR Advisory Group, L.C. and Mr. Albert Koenigsberg;

MANROEL, GELLER AND ASSOCIATES, by Mr. Stuart M. Manroel, on behalf of Nutek Information Systems, Inc., and Mr. Jeffrey A. Shuken; and

Mr. Scott S. Wakefield, Special Assistant Attorney General, and Mr. W. Mark Sendrow, Assistant Attorney General, on behalf of the Securities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

On November 29, 1994, the Securities Division ("Division") of the Arizona Corporation Commission ("Commission") filed a Notice of Opportunity for Hearing regarding Proposed Order to Cease and Desist ("Notice") against Nutek Information Systems, Inc. ("Nutek"), Mr. Jeffrey A. Shuken, A.K.s DAKS Communication, Inc. ("ADC"), SMR Advisory Group, L.C. ("SMR"), and Mr. Albert Koenigsberg. Pursuant to law, all of the above-named Respondents were duly served with the Notice.

In the Notice it was alleged that the Respondents offered for sale securities in the form of membership interests in various limited liability companies ("LLC") within or from Arizona that were not registered pursuant to the Arizona Securities Act ("Act") and were not exempt from any other provisions thereunder, all in violation of A.R.S. § 44-1841 of the Act; that the Respondents in connection with the offers to sell securities, acted as dealers and salesmen within Arizona, although not registered pursuant to the Act in violation of A.R.S. § 44-1842; and that the Respondents, in connection with the offers of securities, directly or indirectly, committed fraud in violation of A.R.S. § 44-1991.

The Division requested that the Commission issue Orders directing that: the Respondents cease and desist from violating the Act pursuant to A.R.S. § 44-2032; the Respondents pay the Commission and administrative penalty of up to $5,000.00 for each violation of law pursuant to A.R.S. § 44-2036; and the Respondents offer rescission, if warranted, to correct the conditions resulting from their acts, practices, or transactions, pursuant to A.R.S. § 44-2032.

On December 14, 1994, Nutek and Mr. Jeffrey A. Shuken filed with the Commission a request for a hearing waiving his and/or Nutek's right to hearing being set within the time frame set forth in A.R.S. § 44-1971 and 44-1972. The Division had no objection to Mr. Shuken's and/or Nutek's request.

On December 16, 1994, by Procedural Order, the Commission indicated to Mr. Shuken and Nutek that, since ADC, SMR, and Mr. Koenigsberg had not yet requested a hearing or waived their right a hearing, the matter would not yet be set for a hearing.

On December 19, 1994, a request for a hearing was filed on behalf of ADC, SMR, and Mr. Koenigsberg waiving their rights to hearing being set pursuant to A.R.S. §§ 44-1971 and 44-1972.

On December 28, 1994, by Procedural Order, the Commission ordered a hearing to commence on February 8, 1995.

On January 11, 1995, ADC, SMR, and Mr. Koenigsberg filed a Motion to Continue the above-captioned proceeding until late March or April 1995 because of a prior commitment of counsel, requesting that the Commission allow for a hearing lasting approximately ten days. Neither the Division, Mr. Shuken, or Nutek objected to this request.

On January 19, 1995, by Procedural Order, the Commission continued the proceeding from February 8, 1995 until April 3, 1995. During the interim period, discovery took place.

On March 3, 1995, Nutek and Mr. Shuken filed a formal answer to the Notice.

On March 17, 1995, by Procedural Order, the Commission ordered the Division, if it intended to charge the Respondents with additional allegations, to request leave and amend its Notice not later than March 24, 1995.

On March 24, 1995, the Division filed a Motion to Amend the Notice which did not add any additional Respondents, but set forth additional facts supporting its allegations that the Respondents violated the Act. Including in the additional allegations contained in the Amended Notice was information concerning the offering which had been made by the Respondents and the fact that at least 16 Arizona residents had invested.

On April 3, 1995, by Procedural Order, the Commission granted the Division's Motion to Amend the Notice.

On April 3, 1995, a full public hearing was commenced before a duly authorized Hearing Officer of the Commission at its offices in Phoenix, Arizona. At that time, Respondents appeared with counsel and filed a pre-hearing memorandum of law. The Division appeared and was represented by counsel. Testimony was taken and over 125 exhibits were admitted into evidence during the course of the proceeding. At the conclusion of the hearing, the matter was taken under advisement pending submission of a Recommended Opinion and Order to the Commission.

On June 22, 1995, the Respondents joined in filing their closing memorandum in the form of Proposed Findings of Fact and Conclusions of Law. The Division also filed its closing memorandum on that date.

DISCUSSION

I. Background

During all relevant times herein, ADC was a Florida corporation owned solely by Mr. Koenigsberg, its President. SMR was a Texas LLC, the majority interest of which was owned by Mr. Koenigsberg, its President and CEO.

Nutek was a California corporation employed by ADC, SMR, and Mr. Koenigsberg as an independent sales office ("ISO") to market membership interests in LLCs.

Mr. Shuken was employed by Nutek and, according to records from the California Secretary of State, was its Chief Financial Officer and a corporate director.

From approximately March 1994 until January 1995, ADC, SMR, and Mr. Koenigsberg were involved in the formation and subsequent offer and sale of investment opportunities in the form of membership interests in 40 separate LLCs recently formed by them in Texas that were to be engaged in the communications business. Investors in the LLCs were secured through telephone solicitations and offering materials which were mailed to them by the Respondents. Acting on behalf of the LLCs, ADC and SMR were to secure leases from the Federal Communications Corporation ("FCC") licensees, construct, maintain, and operate a 220-222 MHZ ("220 MHZ") business communications system. The Respondents represented that the system would be capable of providing services such as dispatch service, private calling, interconnect calling, call forwarding and roaming dispatch networking. The proposed venture involved the LLCs entering into a cooperative operating relationship utilizing compatible systems which were to be joined together in the Western Regional Network ("WRN"). The WRN was to extend from the State of Washington southward through Oregon and California and extend eastward into Nevada in the vicinity of Reno and Las Vegas.

On October 18, 1994, a Division investigator, Mr. Kenneth Oliverio, spoke by phone with Mr. Shuken at Nutek's office, located in San Diego, California. Mr. Shuken spoke with Mr. Oliverio about investing in an LLC that was to be part of the WRN. Subsequently, on

November 7, 1994, Mr. Oliverio had an additional conversation with Mr. Shuken regarding an investment in an LLC. During this conversation Mr. Shuken informed Mr. Oliverio that he would be able to invest in an LLC known as Washington 220 Holdings. Membership interests in the respective LLCs were sold in a range from $2,000 to $3,500 per unit with each LLC being made up of 100 units[1]. It was also explained that investors in the LLCs would only be liable for their capital investment in the event the entity failed. It was further represented to Mr. Oliverio that after the 40 LLCs' membership interests were sold out, the LLCs would unify their operations into the WRN[2] in order to generate the maximum amount of revenue from providing a communications service similar to cellular telephones.

The initial offering materials sent to Mr. Oliverio and prospective investors led them to believe that the actual negotiation for the leases of the FCC licenses, construction and management of the LLCs would be handled by ADC and SMR.

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[1] The LLCs membership interests were to be owned 72 percent by investors, 20 percent by the FCC's license holder and 8 percent by SMR.

[2] The initial offering materials described the WRN at note three as follows: "the WRN is a proposed entity which SMR has planned to serve as a tie between the proposed and existing 40 LLCs. The form of this entity has not yet been decided as of the date of this report. Each of these LLCs will possess a license for a mobile communications radio system operating in the 220 MHZ band in California and surrounding area. This proposed organization is subject to FCC and the LLC corporation shareholder approvals."

The initial offering materials which were sent to Mr. Oliverio and prospective investors contained: some brief promotional materials from ADC explaining 220 MHZ communication service; a financial forecast for the WRN based on an accountant's compilation report resulting from representations of SMR with ADC; various background biographies concerning ADC, SMR and their officials; and a signature page for investors to reserve a designated number of units at the going rate per unit, to be returned along with their checks to SMR via Federal Express. Some of the signature pages sent to prospective investors in the respresentative LLCs contained information that a Membership Summary and membership purchase documents relative to the particular LLCs would be forwarded to the investors. The prospective investors were given seven days in which to examine the documents and request a refund in writing if they chose to do so.

At the time prospective investors sent their reservations to SMR for the requested number of membership interest units together with their payments, investors were offered an opportunity to pay an extra $25.00 as a fee for a compliance interview to be conducted subsequently by an independent company known as Compliance Interviews of America ("CIA"). During the interview, investors were to be questioned with regard to their understanding that their investments represented risk capital and subject to total loss if the respective LLC failed. When the Division's investigator contacted CIA, its representatives explained that he was to ask an investor a standardized set of 18 questions to ensure that investors were not misled by ISOs such as Nutek.

A number of proxy ballots were also sent to investors prior to any disclosure being made wherein the investors were asked to ratify ADC's and SMR's actions for the selection of the equipment that was used to construct the transmission sites of the various LLCs, to pay for the construction of an office for a firm known as Pagers Plus Cellular ("PPC") that was to market the services of the LLCs, to utilize SMR as an administrator for the LLCs, and to form the network to be known as the WRN as outlined in the initial offering materials. There is no evidence that investors were offered a thorough discussion of the options available to them when proxies were sent for their vote and it appears that early proxies mailed to investors were treated as affirmative votes if they were not returned by investors and that later proxies were treated as "negative votes" if they were not returned.

In January 1995, ADC and SMR sent a Membership Summary to each investor in the various LLCs who had previously paid for their membership interests. It was referred to as the "Brick" and began with a provision informing the investor that he had made a reservation in a particular LLC and that he had the right at that time to either become a member of the LLC or to decline membership within seven calendar days from the date of receipt of the Brick and to request, in writing, a full refund of the reservation fee. It was also noted that an investor became a member by either subscribing to the enclosed subscription agreement or by failing to request a refund in writing within the seven day period which would be deemed a waiver of his right to request a refund.

The Membership Summary contained full descriptions of the respective LLCs including a glossary of terms; a summary of the offering; nine pages describing the risk factors associated with the offering; a description of the business of the company which described the interrelationship of the respective LLC with ADC and SMR and their officials including Mr. Koenigsberg, their President; a description of the Class A and Class B membership interests; the LLC's regulations; and a description of the subscription procedure for investors who had previously paid for and had reserved units in the respective LLCs. The Brick also contained a number of exhibits as follows: financial statements compiled for the respective LLC; the LLC's Articles of Organization; any amendments to the Articles of Organization; the complete regulations of the LLC; a copy of the administrative agent agreement with ADC; a copy of a representative membership recruiter agreement; a sample of a management and construction agreement with a licensee; a copy of the management and construction agreement with SMR; a representative copy of an agreement to perform compliance interviews by CIA; and a copy of a license agreement or an antenna site lease with the FCC licensee.

All investors in the respective LLCs had previously paid for their membership interests in most cases at least several months prior to their receipt of the Membership Summaries. The Membership Summaries clearly disclosed and warned of the highly speculative and risky nature and lack of liquidity of an investment in the respective LLCs. It was pointed out that the LLCs had no operating history and there were no guarantees of success and they were facing challenges raised by various securities regulators including the instant proceeding in Arizona which could create problems for investors. The disclosures made within the "Risk Factors" portion of the respective Membership Summaries while not necessarily industry specific made it reasonably clear using boiler plate warning language that an individual investor was making a highly risky investment. While the formation of the WRN had been promoted in the initial offering materials sent to investors, the Membership Summaries made it clear that the WRN was merely a proposal and that there was no guarantee that it would ever exist or that a respective LLC would become a member of any such network.

On January 6, 1995, a certified public accounting firm, Keefe McCullough & Co., ("Keefe") wrote to ADC as the administrative agent of the LLCs stating that it had found that membership reservation fees in the respective LLCs were being combined into a single administrative account to fund purchases of communications equipment and other expenses and then being charged back to the respective LLCs. Keefe also noted that the expenditures for equipment and expenses were from funds that were subject to refund claims. The firm also pointed out the specifics of the risks related to the lack of an operating history, anticipated negative cash flows and the fact that there were no assurances of profitability for the various LLCs.

A copy of Keefe's letter was included in the compilation of Financial Statements in the Membership Summaries sent to the investors in the respective LLCs formed by ADC, SMR and Mr. Koenigsberg, but this disclosure was not made prior to an investor committing his funds.

When the Membership Summaries were sent out in January 1995, they showed that 60 percent of the funds invested in the various operating LLCs had already been expended. The Membership Summaries also revealed that the ISOs had been paid sales commissions of approximately 33 percent of the funds collected to sign up investors in the respective LLCs and 12 percent of the funds raised had been paid to ADC for its administrative fees and for equipment which had been purchased.

Before investors were sent their Membership Summaries, in order to facilitate the operations of the respective LLCs, ADC and SMR established the formation of management committees which were categorized as follows: finance and administration; engineering; license acquisition and expansion; legal; advertising and marketing; and equipment purchasing and upgrades. Investors were given the opportunity to apply for official positions with their respective LLCs or their management committees which they had been asked to approve by proxy by SMR.

Over the course of the offering in the 40 LLCs from March 1994 through January 1995, approximately 920 individuals invested a total of $10,400,000.00, including 17 Arizonans who invested $147,500 in 15 of the LLCs. In January 1995, members of all of the LLCs met in Sacramento, California and the members of the respective LLCs elected not to form the WRN at that time. Following the organizational meeting of all the LLCs in Sacramento, California, ADC and SMR made refunds to any investors who requested them including two of the 17 Arizona investors who received complete refunds of the $13,000 which they had invested.

II. Does a Membership Interest in an LLC Constitute a Security?

The Division alleges that the membership interests in the respective LLCs which were proposed to make up the WRN, when considering the entire investment scheme involved, constitute either investment contracts, preorganization certificates or subscriptions and, therefore, are securities under the Act. These terms are used to define a security under A.R.S. § 44-1801(22). The Division has also taken the position that the investments in the respective LLCs should be characterized as securities at the time investors invested their monies or as characterized by the Respondents when they made their "reservations". Pursuant to A.R.S. § 44-1801(18), "sale" or "sell" are defined as "a sale or other disposition of a security or interest in a security for value and includes a contract to make such a sale or disposition".

The controlling case in this area to determine whether or not the offer and sale of the membership interests in the respective LLCs offered by the Respondents constitute a security is *S.E.C. v. W.J. Howey Co., et al.*, 328 U. S. 293, 66 S. Ct. 1100, 90 L. Ed. 1244 (1946) ("*Howey*"), as modified in *United Housing Foundation v. Forman*, 421 U.S. 837 (1985) ("*Forman*"), wherein the United States Supreme Court devised a three-prong test to determine whether an instrument is an investment contract. Using the *Howey* test, an instrument (the membership interest reservation) is an investment contract if it evidences: (1) an investment of money; (2) in a common enterprise with an expectation of profits; and (3) which are derived substantially from the efforts of others. This test has been adopted by this Commission, our courts in Arizona, and the Ninth Circuit Court of Appeals. The *Howey* test is an objective standard which requires a transaction to be characterized at the time it transpired. *Daggett v. Jackie Fine Arts, Inc.*, 152 Ariz. 559, 565, 733 P.2nd 1142, 1148 (App. 1986).

In the instant case, the evidence strongly suggests that the Respondents, SMR, ADC, and Mr. Koenigsberg utilized the respective LLCs as investment vehicles to raise capital for the construction of the transmission sites in order to beat the FCC's deadline to begin construction on all sites by December 2, 1994, because the promoters would not be able to complete, in the limited time available, a full blown public offering which would meet the requirements of the Act. This evidence is supported by the testimony of Mr. Jay Valinsky, a securities attorney called as a witness by the Respondents. By utilizing the sale of membership interests in the LLCs which are not specifically defined as securities under the Act, the Respondents obviously hoped to avoid the scrutiny that would be placed upon them in a public offering. The Respondent's contention that the membership interests in the LLCs should be considered as interests in general partnerships does not overcome this evidence. In determining the scope of protection offered by the Act, however, Arizona courts look to the underlying economic reality of a transaction, disregarding the form in favor of substance. *Rose v. Dobras*, 126 Ariz. 209, 624 P.2nd 887 (App. 1981).

In applying the *Howey* test to the evidence concerning the offer and/or sale of the membership interests in the instant case, the evidence supports the conclusion that the membership interests are securities under the Act.

A. Investment of Money

An "investment of money" is typically defined as a commitment of capital to an enterprise with the expectation of gaining a profit while subjecting the investor to a risk of financial loss. *Hector v. Wiens*, 553 F.2nd 429, 432 (Ninth Cir. 1976). In this case, 17 Arizona residents invested a total $147,500.00 between March 1994 and January 1995 in 15 of the 40 LLCs formed by the Respondents that were proposed to make up the WRN. Ostensibly, the commitment of these monies returned with the "signature page" of the offering materials were merely reservations, but they amount to investment contracts, preorganization certificates or subscriptions which are securities under the Act. While some of the investors were advised on their signature pages that they would have an opportunity to seek a refund within seven days of the receipt of the Brick, other investors were not advised of this possibility at the time their monies were tendered. It does not appear that the Respondents had adequate monies to refund all investors' funds if they chose to seek a refund once it was offered and thus their capital was at risk in the enterprise from the very beginning. The Respondents' position that the capital of the investors in the respective LLCs was not at risk until after receipt of the Membership Summaries and passage of the seven day review period is inconsistent with the evidence. Thus, we find that the first prong of the *Howey* test is met.

B. A Common Enterprise with an Expectation of Profits

As determined in Arizona, a "common enterprise" for purposes of the *Howey* test requires that the fortunes of the investor become interwoven with and dependent on the endeavors and gainful achievement of those seeking the investment of third parties. Arizona courts have developed two tests to determine whether a common enterprise with an expectation of profits exists satisfying the second-prong of the *Howey* test; if either or both of these tests are satisfied, the common enterprise requirement is satisfied:

(a) *Horizontal Commonality*: is found with pooling of investor funds which are collectively managed by the promoter or a third party. The record establishes that members' monies for the respective LLCs membership interests were pooled together and collectively managed by ADC and Mr. Koenigsberg who was the only signatory to the accounts. Clearly, the horizontal commonality test is met here.

(b) *Vertical Commonality*: is found when there is a positive correlation between the success of the investor and the success of the promoter or some third party without requiring a pooling of investor funds. Since we have found horizontal commonality, we shall not deal with the issue of vertical commonality.

Besides finding a common enterprise with horizontal commonality here, we find evidence which is uncontroverted in the record that investors in membership interest in the respective LLCs expected to earn a profit when they invested and thus the second prong of *Howey* is met.

C. Efforts of Others

The last factor of the *Howey* test requires that an investor's profits be derived substantially from the managerial efforts of others. The Division has pointed out that the Ninth Circuit Court of Appeals in *S.E.C. v. Glenn W. Turner Enterprises, Inc.*, held that the term "solely" in *Howey's* third prong should not be strictly construed ruling that the focus should be on "whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." 474 F.2d 476, 482 (9th Cir. 1973), cert. denied, 414 U.S. 821, 94 S.Ct. 117, 38 L.Ed. 2d 53 (1973). Arizona courts have looked at the "efforts of others" in a broad fashion in determining where the truly significant efforts are made on behalf of investors. There are slightly more than 900 individual investors in the 40 LLCs involved in the enterprise to form the proposed WRN. These investors are scattered primarily throughout the United States with a few from Canada. Clearly, the investors had to rely on the expertise of SMR and its technical staff, ADC and Mr. Koenigsberg if the enterprise was to succeed. In the limited time frame involved, they were responsible for the following: acquisition of licenses and equipment; construction of the transmission sites and related equipment; securing subscribers for the system; developing a billing system; and collecting revenues from the subscribers.

The case of *Williamson v. Tucker*, 645 F.2d 401 (5th Cir. 1981), provides a blueprint to examine the efforts of others test established by *Howey*. The Court there found that an investor is dependent on the efforts of others when he was unable to exercise meaningful partnership powers because of a dependence on the promoter or a third party. As evidence of the dependency of an investor on a promoter or third party, the Court cited the following factors: an agreement among the parties which leaves investors with limited powers comparable to those of a limited partner; the fact that investors are so inexperienced they are incapable of intelligently exercising their partnership powers; or the promoter or manager possesses some unique entrepreneurial or managerial ability such that the investors cannot replace or otherwise exercise meaningful partnership powers.

◆ Agreements limit investors' powers.

The record established that there were numerous agreements involved in the respective LLCs' operations such as: the leases for the FCC 220 MHZ licenses; the leases for transmission sites; the contracts with ADC as an administrative agent; the contracts with SMR to construct transmission sites and operate the systems; and the contracts with PPC to secure subscribers for the respective LLCs. These agreements clearly restrict investors' rights with regard to their exercise of managerial control. The respective LLCs' contracts with SMR are particularly restrictive and onerous in that they are for terms of five years and provide for like renewal periods, which authorization shall not be unreasonably withheld except for gross negligence or fraud as determined by a court of competent jurisdiction[3]. Additionally, the SMR agreements provided for SMR to receive 25 percent of the gross revenues from the operation of each LLC's system on a monthly basis together with an additional monthly payment of $800.00 per channel (under the proposed plan, each LLC was to have five channels) or $4,000.00. Lastly, investors were required, upon receipt of the Membership Summaries, to ratify all prior acts of the Respondents on behalf of the respective LLCs (including the aforementioned agreements) if they remained committed to their investments and did not request a refund.

- Investors in the enterprise lack experience to exercise real control.

The Membership Summary describes the highly technical nature of the business in which the LLCs are to engage in and the problems which they will face in the formation of the WRN. The second factor examined under *Williamson* is whether the investors lack sufficient experience such that, they are incapable of intelligently exercising control over the business in which they have invested. Investments in the telecommunications field while not requiring technical expertise if others are engaged in the management of the business would require a high degree of expertise if one was to be engaged in the active management of the business. Absent the experience of ADC and SMR and its technical staff, investors would be like passengers on a ship in the middle of an ocean without a captain, without power and without a rudder. It is clear that the operations of a 220 MHZ communications enterprise governed by FCC regulations which are highly technical in nature and cannot be readily understood by average investors require them to rely on experts with the necessary technical background and knowledge if their investments are to succeed and to be profitable.

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[3] These contracts required all contract disputes between the LLCs and SMR to be litigated in Florida.

- The Respondents are indispensable to the investors to develop the LLCs.

The *Williamson* court next suggested an evaluation of the promoters' or managers' unique abilities such that the investors cannot easily replace them or otherwise exercise meaningful managerial control as general partners. In the instant case, the respective LLCs are bound to SMR through its restrictive management contracts which are not easily voided or canceled and which were executed before some investors even invested in the LLCs. Further, because of the restrictive covenants in the SMR contracts, the LLCs would be unable to replace SMR without extensive litigation. Essentially, the LLCs without SMR most probably would have been unmanageable and the investments rendered worthless because, among other duties, SMR was to handle billing and collections for the LLCs.

Other factors which should be considered when examining the investors' lack of control is the total number of investors and their geographical separation from SMR's offices in Florida, and where the LLCs were to do business, the western part of the United States. There is no question that SMR, ADC and Mr. Koenigsberg are indispensable to the investors in the LLCs because the investors therein are lacking real control due to contracting away the management of their investments. Here the three *Williamson* factors are found together with others that strongly indicate the investors in the LLCs are depending on the efforts of others (i.e., ADC, SMR and Mr. Koenigsberg) in order to earn a profit on their investments.

Throughout the proceeding, the Respondents argued that the investments described herein did not constitute investments in securities. Their position is that the investment did not take place at the time the initial reservations were made when signature pages were returned specifying the number of units being paid for by the investors, but at the time investors made their elections after receipt of their Membership Summaries.

In support of their position, the Respondents relied strongly upon *Williamson* maintaining that the individual investors in the respective LLCs did not rely upon the efforts of others, and that they possessed the ability to exercise control of their LLCs for purposes of the *Howey* test. The Respondents argued that the investors were involved in 40 separate general partnerships and not an investment in a common enterprise. In support of this argument, the Respondents also cited a long series of cases including *Rivanna Trawlers Unlimited v. Thomason Trawlers,* 840 F.2nd 236 (4th Cir. 1988) and others. These cases started with a presumption that a general partnership existed and that they were not securities. However, the cases cited by the Respondents were factually dissimilar and involved far limited numbers of investors than is the case here.

After analyzing the factors presented in the offering herein, we find that the efforts of others or third prong of *Howey* is met and that the membership interests offered and sold by means of reservations by the Respondents, Nutek, Mr. Shuken, ADC, SMR, and Mr. Koenigsberg in the respective LLCs constitute investment contracts, pre-organization certificates or subscriptions and therefore, are securities under the Act. We believe that the Respondents acted in an innovative manner in order to raise the amount of capital needed in such a short time. In fact, the Respondents began to take action on behalf of the respective LLCs by entering into agreements with the various licenses and beginning construction of the systems even before the LLCs were sold out and before their members could actively participate in their operations. Further supporting our opinion that the membership interests in the respective LLCs constituted securities under the Act is the fact that proxy votes presented to investors merely provided an illusion of control. The investors had no available options presented to them and in some instances, SMR and ADC had already acted on behalf of the respective LLCs. Having found that a membership interest constitutes a security, the Respondents are subject to the provisions of the Act.

III. Did Respondents Offer and/or Sell Unregistered Securities in Violation of the Act?

The Division has alleged that all of the above named Respondents offered and/or sold unregistered securities in violation of Act. Pursuant to A.R.S. § 44-1841, it is unlawful to sell or offer for sale within or from this state any securities unless such securities have been registered by description under §§ 44-1871 through 44-1875 or registered by qualification under §§ 44-1891 through 44-1902, except securities exempt under §§ 44-1843 or 44-1843.01 or securities sold in exempt transactions under § 44-1844.

It is clear from the record that neither Nutek or Mr. Shuken actually sold any investments to any Arizona residents. The only evidence of Nutek's and Mr. Shuken's involvement are the two telephone conversations with the Division's investigator, Mr. Oliverio which took place on October 18, 1994 and November 7, 1994. It is uncontroverted that Mr. Shuken sent the initial offering materials regarding the investment in the enterprise to Mr. Oliverio. The record further established that Nutek had a contract to solicit investors on behalf of a number of the LLCs. It was also shown that Mr. Shuken, according to California state records, was both a Director of and the Chief Financial Officer of Nutek. As such, we conclude that he had the authority to, and did make an offer to Mr. Oliverio despite Mr. Koenigsberg's representations that his understanding of Mr. Shuken's normal duties did not involve direct sales of membership interests in the respective LLCs. Mr. Shuken did not appear at any time during the proceeding to deny the Division's allegations although both Nutek and he were represented by counsel during the proceeding.

With respect to ADC, SMR and Mr. Koenigsberg, it is clear from the evidence that these respondents were directly involved in the offer and sale of unregistered securities within Arizona in violation of the Act. Investors' signature pages containing their subscription agreements were mailed to SMR in Florida together with their funds for their membership interests. These funds were deposited into back accounts which were controlled solely by Mr. Koenigsberg. The Respondents did not dispute this fact. Having determined that the reservations for the membership interests were securities, it is clear from the record that their offer and sale within Arizona, unless they have been registered or are exempt or sold in exempt transactions, is a violation of A.R.S. § 44-1841(A).

IV. Were the Respondents Registered as Dealers or Salesmen?

Pursuant to A.R.S. § 44-1842, it is unlawful for any dealer to sell or purchase or offer to sell or buy any securities, or for any salesman to sell or offer for sale any securities within or from this state, unless the dealer or salesman is registered as such pursuant to the provisions of Article 9 of this chapter.

Based on the record and pursuant to evidentiary stipulations concerning nonregistration between the parties, it is equally clear that neither Nutek, Mr. Shuken, ADC, SMR, nor Mr. Koenigsberg, were registered as either dealers or salesmen, in violation of A.R.S. § 44-1842(A).

V. Were the Respondents' Actions Violative of the Anti-fraud Provisions of the Act?

Pursuant to A.R.S. § 44-1991, it is a fraudulent practice and unlawful for a person in connection with a transaction involving the offer or sale of securities, to directly or indirectly do any of the following:

1. Employ any device, scheme or artifice to defraud.
2. Make any untrue statement of material fact, or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.
3. Engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit.

An objective test is used to determine what is or is not a material fact. In *Trimble v. American Sav. Life Ins. Co.*, 152 Ariz. 548 (App.), 553, 733 P.2nd 1131 (1986), the Arizona Court of Appeals stated, "the test to be met is simply a showing of substantial likelihood that, under all circumstances, the misstated or omitted fact would have assumed actual significant in the deliberations of a reasonable buyer." Those offering an investment opportunity have an affirmative duty not to mislead potential investors. Respondents do not have to intentionally misrepresent material facts or intentionally omit to state material facts. Scienter is not an element of a violation of A.R.S. §§ 44-1991(2) or 44-1991(Illegible). Additionally, the Division is not required to establish that investors relied on the misrepresentations or omissions or that the misrepresentations or omissions caused injury to the investors.

The Division has alleged that the Respondents violated A.R.S. § 44-1991 by misrepresenting material facts and failing to disclose material facts in connection with both their original offers and sales of the membership interests in the LLCs and with their offer of recission in January 1995 and by engaging in a course of business which operated as a fraud or deceit in connection with the original transactions and with the offers of recission. In connection with the offers of sales and securities, the record establishes, through documentary and testimonial evidence, that Respondents violated the [Illegible] fraud provisions of the Act.

A. Respondents misrepresented the type of service which could be provided to generate the bulk of LLC revenues.

Investors and offerees were led to believe that the LLCs would provide cellular telephone-like services to customers in the western United States. Respondent Shuken referred to the service as a "poor man's cellular" when describing the service to the Division's investigator. The original offering materials create an image that the LLC's 220 MHZ communications systems would operate in a fashion similar to cellular communications systems. Representations were also made touting the superiority of 220 MHZ communications service or dispatch service over cellular service. Offering materials represented that substantial portions of what was to be the WRN's revenue would be generated from providing cellular-like service because of projected "inter-connect revenues". Forecasted financial statements also projected significant revenues from the resale of long-distance service.

The primary use of the 220 MHZ frequencies in the past and presently has been for dispatch radio communications or "two-way radio" as it is more commonly known. Dispatch radio is used primarily for mobile radio purposes by business subscribers such as trucking, plumbing, and taxi cab companies which are able to utilize a system where they can speak from a central location to several mobile units at the same time. However, when the need arises users of this form of communication can be inter-connected with local telephone service in order to make a telephone call. It was pointed out that cellular telephone service has an appeal to more of a "white collar" customer who desires to speak only to one individual at a time versus the dispatch customer who may be speaking to several individuals at the same time over his communication service.

A significant difference with cellular service was established when it was pointed out that the 220 MHZ communication system can provide only what is known as half-duplex or simplex communication versus cellular or ordinary telephone communication which is full-duplex communication. The 220 MHZ system permits only one party to talk at a time usually requiring each party to say "over" to signify that he has finished his communication. Full duplex permits both parties to talk and listen simultaneously and is the method of communication with which the vast majority of people relate to when thinking of telecommunications. According to the Division's expert, Mr. Dale Hatfield, these differences are created because of technical reasons brought about by the FCC's narrow channel allocations in 220 MHZ bands and because of the laws of physics which impose an insurmountable obstacle to developing a full-duplex portable dispatch system as opposed to equipment which is employed in a vehicle. In the opinion of the Division's expert, in order to adequately compete with cellular telephone communications systems, full-duplex capability is essential for any communication system.

B. The 220 MHZ systems cannot provide portable cellular like service because dispatch communication units are not available in that frequency.

The record established that no portable equipment is currently available in the frequency to be utilized by the LLCs for commercial purposes to provide either dispatch or telephone-like service. The record further showed that while a prototype portable unit has been developed, it is only a half-duplex unit for use in providing dispatch services and has not yet been approved by the FCC for public sale. Portability is the key factor in the utilization of cellular telecommunications devices and has been responsible for its rapidly increasing growth. Physical limitations of the narrow band frequencies will prevent full-duplex communication in the 220 MHZ communications market and thus limit its economic viability. The fact cannot be explained away that dispatch communication service or 220 MHZ communication systems are unlike cellular communications service in that they lack portability and this factor should be disclosed in the initial offering materials.

C. The 220 MHZ communication system cannot provide service when users travel from one service area to another.

In the original offering materials, investors were lead to believe that the dispatch service offered by the respective LLCs would be competitive with cellular telephone service because they were given the impression that users could travel from one service area to another and the systems would "hand-off" the call from one tower site or base station to another during the user's travels. Cellular systems are capable of "hand-off" as callers travel between cell sites, but because of the narrow bandwith inherent in 220 MHZ communications systems, the base station can not communicate to the mobile unit while the mobile unit is transmitting.

D. Communication inside buildings is limited with 220 MHZ communications systems.

While portable cellular telephone service is more than adequate inside of buildings, the communications systems to be offered by the LLCs would have poor penetration from inside of structures if the user attempted to communicate with others outside of the building. Although penetration would be limited in this instance because of the lower frequencies utilized by the 220 MHZ systems, they would provide a user with greater range and better communication capabilities in rough terrain which pose a problem for cellular users.

E. 220 MHZ equipment is more expensive than cellular telephone equipment.

Another factor which would mislead a prospective investor is the representation that subscribers would be able to obtain 220 MHZ equipment ($500 to $800 per unit) as reasonably as cellular telephone equipment (free and up). The record shows that such is not the case and there are drastic price differences with cellular subscribers able to purchase the initial equipment inexpensively in part because of the subsidization of its purchase price by cellular service providers which garner their revenues from the sale of airtime. However, we must note that charges for 220 MHZ service would appear to be moderately less to subscribers.

F. Other areas of misrepresentation or omissions.

Although offering materials projected 50 percent of the subscribers to the LLCs would use inter-connect service, according to a valuation prepared by a private company at the request of SMR, the valuation of the proposed WRN indicates a system which primarily would provide dispatch services, and not a system involving cellular telephone inter-connect services. The evidence did not establish that the Respondents would be able to provide, through dispatch service, cellular telephone-like service that would be superior to authentic cellular telephone service and there were no specific warnings to this effect to the investors. Further, the financial projections provided to prospective investors were unfounded predictions which would violate the Act's anti-fraud provisions.

While disclaimers and warnings may have been apparent in the Membership Summaries, they were not available in the initial offering materials sent to investors.

The financial projections utilized by the Respondents and sent with the initial offering materials allegedly represented historical experience of the 220 MHZ industry, however, the Division's expert testified in a credible fashion that there is not a sufficient performance history of commercial 220 MHZ systems upon which to base this projection. In the financial projections in the initial offering materials, the Respondents also incorrectly stated the compensation to SMR. While initial financial projections indicated a management fee of 20 percent of net income with a minimum monthly charge of $32,000 for SMR, they conflicted with the construction and management agreements executed between the various LLCs and SMR which provided SMR with 25 percent of gross monthly revenues with a minimum monthly payment of $800.00 per channel system (or $4,000 per LLC if all five channels were fully subscribed).

There is also evidence that the Respondents misrepresented to prospective and actual investors the status of the FCC licenses and actually accepted funds for payment in certain LLCs for which license rights had not yet been secured. In statements made to the Division's investigator, Respondent Shuken represented that the investment involved "very little speculation" and that the "risks have been minimized". Without a license, the LLC could not conduct business and risks were clearly much higher. In fact, the Membership Summaries disclosed that the Respondents expected losses and a negative cash flow for at least one year which was not explained prior to investments being made.

One investor witness, Mr. Jesse Simmons, confirmed that he had not been informed about the possible problems with the investment being considered a security prior to making his investment in August 1994. Nor had Mr. Simmons been told of the action by the State of South Dakota which had ordered the Respondents to cease offering the investment in that state on June 27, 1994. He indicated that facts such as this would have been relevant and material to him prior to making his investment.

Initial offering materials sent to investors failed to disclose the fact that sales commissions approximately 30 percent were being paid to ISOs such as Nutek which were engaged to find prospective investors for the respective LLCs. Additionally, there was a failure to disclose information to prospective investors concerning the financial condition and business history of ADC and SMR. The Division argued that this is material information and important to prospective investors because it indicates the ability of the promoter to carry on the operations of the venture in its start-up condition. The Division also disagreed with the Respondents' practice of charging prospective investors for a compliance interview after an investment since disclosure should have been made to prospective investors prior to monies being sent to SMR. The Division believes that because the Respondents made material misrepresentations and omitted certain material facts from the offer and sale of the membership interests, their actions constitute a fraudulent course of business and violate A.R.S. § 44-1991(3).

The Respondents' Position

The Respondents argued that the investments in the respective LLCs did not constitute an investment in a security. In this respect, the Respondents relied upon the *Williamson* test and other Supreme Court cases which flow from it with regard to the degree of control exercised by an investor to show that the investment did not constitute a security, but was instead an interest in a general partnership. Based on these arguments, it is obvious that the Respondents did not treat the offer and sale of these membership interests as securities with regard to the disclosure made in the initial offering materials.

However, the Membership Summary or Brick which was sent to all investors in their respective LLCs in January 1995 was extremely candid and began with a proviso advising investors that they had seven calendar days from the date of receipt to examine the Membership Summary and to request a full refund or elect to retain their investment in the respective LLC.

Each respective LLC's Membership Summary that was admitted into the record displayed an initial disclosure on the second page that the membership interests involved a "high degree of risk" and also informed investors that "the issue of whether an interest in a limited liability company constitutes a security, and therefore, must be offered and sold in accordance with applicable federal and state securities laws, is not settled." The Respondents did not hide these facts from investors in the Membership Summary, but these disclosures did not appear in the initial offering materials. Investors were also advised that the membership interests had not bee registered under any federal or state securities laws.

The Respondents argued that the "Risk Factors" section of each Membership Summary which consisted of nine pages, more than adequately disclosed the nature of the risks associated with an investment in the respective LLCs. There, the Respondents openly disclosed the fact that the LLC had no operating history and anticipated a negative cash flow for at least the next fiscal year and no assurances of whether profits would ever be attainable. Warnings were also given concerning the fact that there was uncertainty of market acceptance and that challenges had been brought in some states including Arizona as to the status of the LLC's membership interests constituting securities. It was also pointed out by the Respondents that problems could arise with meeting certain FCC requirements which could result in a potential loss of an investor's entire investment. These warnings were generally of a boiler plate nature, and can be found in most prospectuses in the securities industry.

The Respondents made it clear that the cornerstone of their investment program involved an opportunity for the investors to secure a refund if they chose not to proceed with their investment upon receipt on the respective Membership Summary. At that time, the seven day examination period began and investors had the opportunity to either elect to continue with their investment or request a full refund. In the case of the 17 Arizona investors, the Respondents made full refunds to two investors who chose not to proceed with their investment in the

LLCs.[4] Mr. Koenigsberg also indicated that full refunds were also made to other investors who chose not to proceed with their investments following the January 1995 meeting in Sacramento, California of LLC members.

To further support their position that investors had a participatory interest and exercised a degree of control over the respective LLCs, the Respondents presented a demonstration of a prototype voice response unit which was to replace the use of written proxies in the future so that the investors could more actively participate in the management and control of their LLCs.

The investor witnesses who testified in the proceeding on behalf of the Respondents generally displayed a knowledge of their investment and satisfaction with the management of the respective LLCs by the Respondents herein. these witnesses also appeared to have some technical and business knowledge and could appreciate the risks of investing in the LLCs. The Respondents' technical witnesses also testified credibly that the venture has the potential to succeed.

CONCLUSION

Based upon our review of the evidence in this proceeding, it is our conclusion that the Division's allegations with regard to the main issue of whether the offer and sale of the membership interests in the respective LLCs constitute the offer and sale of a security has been proven. We believe that the evidence is overwhelming in this regard. The LLCs could not have effectively functioned and conducted business in the manner in which they were to operate without the Respondents because of complexities inherent in the communications industry and because investors were scattered throughout the United States. It is clear that the key management and control decisions were to be exercised by the Respondents, SMR, ADC and Mr. Koenigsberg.

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[4] One of these investors was Mr. Jesse Simmons.

We can appreciate the difficulties faced by Mr. Koenigsberg, ADC and SMR in the formation of the respective LLCs to establish a dispatch communications system network covering a vast geographic area. We can also appreciate the almost insurmountable obstacles that Mr. Koenigsberg faced in raising such a large sum of money in a relatively short period of time in order to form the LLCs and construct the systems which could be joined as the WRN. The formation of the LLCs and monies raised for their formation was the only conceivable method available to meet the FCC construction guidelines since there was not enough time for a public offering to take place, Essentially, this case is one of timing which forced the Respondents to raise the financing necessary to construct the 220 MHZ dispatch communication systems without making the disclosures required in a public offering. Overcoming obstacles does not excuse the Respondents disregard for the securities laws of the respective jurisdictions including Arizona's in which the offer and sale of the LLC membership interests took place without adequate disclosure of the risks being made to investors before they invested.

However, in finding that the Respondents offered and sold a security in violation of the Act in Arizona, we must also take in to consideration the fact that the Respondents also made good on their pledge to refund the total investment of any Arizona investors who wished to withdraw form the offering after their receipt of the Membership Summaries in the respective LLCs. More often than not, experience has shown that promoters fail to make good on refund offers. While the Membership Summaries adequately disclosed the risks, they were not disclosed to investors so that they could make an informed decision before investing.

Having found that the offer and sale of the membership interests in the respective LLCs to Arizona investors constitute a violation of the Act, we shall order the appropriate sanctions against the Respondents who bear the responsibility for promoting the offering. Such sanctions include, but are not limited to, ordering the Respondents to cease and desist from violations of the Act, requiring the Respondents to make an offer of rescission to investors, and assessing the appropriate administrative penalties of up to $5,000 for each violation of the Act. From our review of the evidence, it is clear that the Respondents who bear primary responsibility in this proceeding are ADC, SMR, and Mr. Koenigsberg. The record with regard to Nutek and Mr. Shuken involve only the offer of a security to the Division's investigator. There is no evidence that either Nutek or Mr. Shuken made any other offers or sales to any Arizona residents.

Based on the record, Respondents, Nutek, Mr. Shuken, ADC, SMR, and Mr. Koenigsberg should be ordered to cease and desist from violations of the Act pursuant to A.R.S. § 44-2032. Nutek and Mr. Shuken offered for sale in Arizona unregistered securities in the form of either investment contracts, preorganization certificates, or subscriptions in violation of A.R.S. § 44-1841. Neither Nutek nor Mr. Shuken were registered as either a dealer or a salesman within Arizona pursuant to the Act and therefore their conduct violates A.R.S. § 44-1842. There is evidence that Mr. Shuken misrepresented the nature of the risk in violation of A.R.S. § 44-1991. Although the record establishes Nutek's and Mr. Shuken's involvement, it is not crucial to the investment scheme and there is no evidence they made any other offers or sales in Arizona. Therefore, we shall order the appropriate administrative penalties be assessed against Nutek and Mr. Shuken pursuant to A.R.S. § 44-2036.

With regard to ADC, SMR and Mr. Koenigsberg, we find their actions constituted a violation of A.R.S. § 44-1841 in the offer and sale of unregistered securities within Arizona in the form of investment contracts, preorganization certificates or subscriptions and that these transactions were carried out by them in violation of A.R.S. § 44-1842 while acting as either unregistered dealers or as a salesman, ADC, SMR and Mr. Koenigsberg must also bear the responsibility for the failure to warn investors of the risks in the initial offering materials in violation of A.R.S. § 44-1991. Since we have found these violations with regard to the primary promoters in the proceedings, we believe that they should be ordered to cease and desist pursuant to A.R.S. § 44-2032 and assessed an appropriate administrative penalty hereinafter pursuant to A.R.S. § 44-2036 for the violations described hereinabove. Additionally, since ADC, SMR, and Mr. Koenigsberg are the Respondents primarily responsible for the venture described herein, pursuant to

A.R.S. § 44-2032, we shall also issue an order directing them to make an offer of rescission in conformance with A.A.C. R14-4-308 to all remaining Arizona investors in the LLCs discussed hereinabove.

****

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. Nutek, whose last known business address is 6390 Greenwich Drive, Suite 110, San Diego, California 92122, is a California corporation which was at all relevant times doing business within or from Arizona.

2. Mr. Jeffrey A. Shuken, whose last known business address is 6390 Greenwich Drive, Suite 110, San Diego, California 92122, was, at all relevant times, doing business within or from Arizona as a Director of and Chief Financial Officer of Nutek.

3. ADC, whose last know [sic] business address is 3801 North University Drive, Suite 350, Sunrise, Florida 33351, is a Florida corporation which was, at all relevant times, doing business within or from Arizona.

4. SMR whose last known business address is 3801 North University Drive, Suite 350, Sunrise, Florida 33351, is a Texas limited liability company which was, at all relevant times, doing business within or from Arizona.

5. Mr. Albert Koenigsberg, whose last known business address is 3801 North University Drive, Suite 350,

Sunrise, Florida 33351, was at all relevant times doing business within or from Arizona as President and CEO of SMR and owning its majority interest. He is the President and sole shareholder of ADC.

6. On November 29, 1994, the Division issued the Notice against the above-named Respondents and which was subsequently amended on March 24, 1995.

7. From the beginning of approximately March 1994 until January 1995, ADC, SMR and Mr. Koenigsberg were involved in the formation and subsequent offer and sale of membership interests for approximately $3,000 per unit in 40 separate LLCs formed by them in Texas to obtain FCC licenses, construct and operate the proposed WRN, a partnership group of 220 MHZ dispatch communication systems.

8. It was proposed that WRN would extend from the State of Washington southward into California and eastward into Nevada and enable the respective LLCs to earn significant income for their investors.

9. Nutek was employed as an ISO to market the membership interests in the respective LLCs by ADC, SMR and Mr. Koenigsberg.

10. On October 18 and November 7, 1994, Mr. Shuken spoke with a Division investigator and offered him an investment opportunity and up to three membership interests in a LLC currently being offered which was known as Washington 220 Holdings.

11. Mr. Shuken represented to Mr. Oliverio that there would be very little risk involved in an investment in a LLC.

12. Subsequently, Mr. Shuken sent initial offering materials similar to those sent to other investors which were of a promotional nature and did not disclose the risks involved in the investment.

13. After prospective investors signed and returned their signature sheets together with their payments for the requested number of units for their membership interests, if they paid an extra $25.00 for a compliance interview, they were contacted by an independent company known as CIA in order to confirm that investors understood their investments were subject to total loss if the respective LLC failed.

14. Monies sent to SMR for investment in the respective LLCs were combined into a single administrative account to fund construction and purchases of equipment and later charged back to the respective LLCs.

15. The risks involved in the investments in the respective LLCs were not disclosed until January 1995 when the Membership Summaries were mailed to the investors for their review in order to make a determination as to whether to elect to continue with the investment or to request a refund.

16. Prior to the Membership Summaries being sent to investors in the respective LLCs, 60 percent of the invested funds had been expended by January 1995 before any requests for refunds were made.

17. Prospective investors were not told that the ISOs were paid approximately 30 percent of the funds collected to sign up investors in the respective LLCs.

18. The proxy votes provided to investors in the respective LLCs provided the investors with illusory control because the actual management and administration of the respective LLCs had been contracted to ADC and SMR.

19. As discussed hereinabove, with respect to the offer and sale of the membership interests in the respective LLCs:

A. Respondents failed to inform investors in respective LLCs of the extent of the risks involved prior to their investments;

B. Respondents failed to inform investors that their entire investment was at risk and that their investments would lack liquidity prior to investing;

C. Respondents misrepresented the nature of 220 MHZ dispatch communication systems by referring to it as "poor man's cellular";

D. Respondents misrepresented that substantial portions of the LLCs' revenues from "inteconnect revenues" and from the resale of long-distance service contrary to a study prepared by a private company at the request of SMR;

E. Respondents failed to inform the investors that 220 MHZ communications service is half-duplex communication versus cellular telephone communications which is full-duplex communication;

F. Respondents failed to inform investors that there was no portable cellular-like equipment available for public usage presently;

G. Respondents failed to inform investors of the transmission limitations of 220 MHZ dispatch communication systems prior to their investments;

H. Respondents failed to inform investors that 220 MHZ equipment is more expensive than cellular telephone equipment because of the subsidization by cellular service providers;

I. Respondents failed to inform investors that the industry lacked a sufficient performance history upon which to make their financial projections prior to investments being made;

J. Respondents misrepresented the costs of SMR's management fees prior to investments being made;

K. Respondents failed to inform investors of regulatory actions with regard to the offer of the investments in the respective LLCs prior to investment being made which could affect the value of the investments; and

L. Respondents failed to disclose to investors the financial condition and business history of ADC and SMR prior to investments being made.

20. The Membership Summaries sent to investors in the respective LLCs some months after their investments had been made, contained reasonable disclosures of the risk factors involved in the investment in the LLCs, but these warnings were given after the investments had been made.

21. The Membership Summaries made it clear that investments in the respective LLCs were highly speculative and that they lacked liquidity and the fact that the

promoters were also facing challenges raised by various securities regulators including the instant proceeding which could affect the value of the investments.

22. The record established that 17 Arizonans invested $147,500 in 15 of the 40 LLCs.

23. Based on the record, it was subsequently shown that two of the 17 Arizona investors subsequently requested and received complete refunds of the $13,000 which they had invested.

CONCLUSIONS OF LAW

1. The Commission had jurisdiction over this matter pursuant to Article IX of the Arizona Constitution and A.R.S. § 44-1801 *et.* [sic] *seq.*

2. The investments offered by the Respondents were securities within the meaning of A.R.S. § 44-1801(22).

3. The securities were neither registered nor exempt form registration pursuant to A.R.S. § 44-1801, *et.* [sic] *seq.*

4. The actions and conduct of the Respondents constitute the offer and/or sale of securities within the meaning of A.R.S. §§ 44-1801(12) and 44-1801(18).

5. Respondents offered and/or sold unregistered securities within or from Arizona in violation of A.R.S. § 44-1841.

6. Respondents are dealers or salesmen within the meaning of A.R.S. §§ 44-1801(9) and 44-1801(19).

7. Respondents offered and/or sold securities within or from Arizona without being registered as dealers or salesmen in violation of A.R.S. § 44-1842.

8. Respondents violated the anti-fraud provisions of A.R.S. §§ 44-1991(2) and (3) in the manner set forth hereinabove.

9. Respondents Nutek, Mr. Shuken, ADC, SMR and Mr. Koenigsberg are found herein to have violated the Act, should cease and desist pursuant to A.R.S. § 44-2032 from any future violations of A.R.S. §§ 44-1841, 44-1842 and 44-1991 and all other provisions of the Act.

10. Respondents ADC, SMR and Mr. Koenigsberg should be ordered to make an offer of rescission pursuant to A.R.S. § 44-2032 and A.A.C. R14-4-308 to the remaining Arizona investors as described hereinabove.

11. Respondents Nutek and Mr. Shuken should be assessed an administrative penalty pursuant to A.R.S. § 44-2036, as follows: for the violation of A.R.S. § 44-1841 the sum of $1,000; for the violation of A.R.S. § 44-1842 the sum of $1,000; and for the violation of A.R.S. § 44-1991 the sum of $1,000.

12. Respondents ADC, SMR and Mr. Koenigsberg should be assessed an administrative penalty pursuant to A.R.S. § 44-2036 as follows: for the violation of A.R.S. § 44-1841 the sum of $5,000; for the violations of A.R.S. § 44-1842 the sum of $5,000; and for violations of A.R.S. § 44-1991 the sum of $5,000.

ORDER

IT IS THEREFORE ORDERED that pursuant to the authority granted to the Commission under A.R.S. § 44-2032, Respondents Nutek Information Systems, Inc., Mr. Jeffrey A. Shuken, A.K.s DAKS Communications, Inc., SMR Advisory Group, L.C., and Mr. Albert Koenigsberg shall cease and desist from their actions described hereinabove in violation of A.R.S. §§ 44-1841, 44-1842 and 44-1991.

IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under A.R.S. § 44-2036 that Respondents Nutek Information Systems, Inc., and Mr. Jeffrey A. Shuken shall jointly and severally pay as and for administrative penalties: for the violation of A.R.S. § 44-1841 the sum of $1,000; for the violation of A.R.S. § 44-1842 the sum of $1,000; and for the violation of A.R.S. § 44-1991 the sum of $1,000.

IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under A.R.S. § 44-2036, Respondents A.K.s DAKS Communications, Inc., SMR Advisory Group, L.C., and Mr. Albert Koenigsberg shall jointly and severally pay as and for administrative penalties: for the violation of A.R.S. § 44-1841 the sum of $5,000; for the violation of A.R.S. § 44-1842 the sum of $5,000; and for the violation of A.R.S. § 44-1991 the sum of $5,000.

IT IS FURTHER ORDERED that the administrative penalties shall be made payable to the State Treasurer for deposit in the General Fund of the State of Arizona.

IT IS FURTHER ORDERED that the $5,000 administrative penalties assessed hereinabove against A.K.s DAKS Communications, Inc., SMR Advisory Group, L.C., and Mr. Albert Koenigsberg shall be reduced to $3,000 per statutory violation if rescission is made in accordance with the terms of this Decision hereinafter.

IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under A.R.S. § 44-2032 Respondents A.K.s DAKS Communications, Inc., SMR Advisory Group, L.C., and Mr. Albert Koenigsberg shall make an offer of rescission to all remaining Arizona investors pursuant to A.A.C. R14-4-308, subject to any legal setoffs for rescission made prior to the effective date of this Decision, said offers of rescission to be made within 60 days from the effective date of this Decision.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

/s/ Renz D. Jennings
CHAIRMAN

/S/ Marcia Weeks
COMMISSIONER

/s/ Carl J. Kunasek
COMMISSIONER

IN WITNESS WHEREOF, I, JAMES MATTHEWS, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 22 day of August, 1996.

/s/ James Matthews
JAMES MATTHEWS
EXECUTIVE SECRETARY

DISSENT ___________
MES:dap

SERVICE LIST FOR: NUTEK INFORMATION SYSTEMS, INC.; JEFFREY A. SHUKEN; AKS DAKS COMMUNICATIONS, INC.; SMR ADVISORY GROUP, L.C.; and ALBERT KOENIGSBERG

DOCKET NO.: S-3046-I

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SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CLERK OF THE COURT

HON. JONATHAN H. SCHWARTZ

July 16, 1997 Y. Cheney

N° CV 96-20499 Deputy

FILED: JUL 18 1997

NUTEK INFORMATION SYSTEMS, INC., et al.

Paul J. Roshka, Jr.
#009285

v.

ARIZONA CORPORATION COMMISSION

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Attorney General
By: W. Mark Sendrow
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This matter having been taken under advisement, the Court finds and rules as follows.

The decision of the Defendant Arizona Corporation Commission (ACC) is affirmed because it is supported by substantial evidence in the record.

The investment is an investment contract pursuant to A.R.S. § 44-1801(22). In addition, the facts before the Commission warranted a finding under Arizona law that this case involved investment contracts under the Arizona Securities Act. *Rose v. Dobras,* 128 Ariz. 209, 624 P.2d

887 (App. 1981); *Daggett v. Jackie Fine Arts, Inc.*, 152 Ariz. 559, 733 P.2d 1142 (App. 1986).

The investors did not gather together to make their own initiated plan and form a general partnership. Therefore, the case of *Williamson v. Tucker*, 645 F.2d, 404, (5th Circuit), *cert. denied*, 454 U.S. 897 (1981) is not applicable. Instead, the investors were solicited by the Plaintiffs. The Plaintiffs put together a plan to sell the investment to people. Investors were actively recruited by salesmen.

Although the average size of each LLC was approximately 24 people, the investment was sold with the specific purpose of the LLC's joining together to form a WRN, Western Regional Network. As Plaintiff, Shuken, told the investigator of the ACC, the idea was to build the WRN to serve as a tie between the existing 40 limited liability corporations. The network was advertised as "seamless" from Portland, Oregon through to Middle California. The 220 - 222 MHz systems in California were advertised "for integration into regional network, including Washington, Oregon, and Nevada." The evidence supported the ACC conclusion that when grouped together as proposed by the Plaintiffs, the investors would be approximately 900 people scattered over various states. The evidence is substantial for supporting the ACC conclusion that the size of the group and their investor geographic location would prevent active management by the investors.

Pursuant to *S.E.C. v. W. J. Howey Co.*, 329 U.S. 293, 66 S.Ct. 1100 (1946), the ACC had substantial evidence to conclude that the investors would be potentially making money through the efforts of others. *S.E.C. v. Glenn Turner Enterprises*, 474 F.2d 476 (9th Circuit), *cert. denied*, 414 U.S.

821 (1973). The evidence sustains the ACC finding that investors were not in control of the management decisions. Instead, SMR already had a five year contract for management. The contract at a minimum provided for SMR to acquire licenses and equipment, construct systems, enlist subscribers, bill subscribers, and collect revenues. The agreements that secured the rights to the 220 MHz licenses, the tower space, to hire AKS DAKS as the administrative agent, to hire contractors to load the systems, and finally hiring SMR to construct and repair the systems did not practically give the investors managerial control.

The SMR agreement allowed SMR, without limitation, the authority to direct the LLC to take or not take any action concerning the system, including access to the facilities at all times and the authority to act independently of the LLC with respect to the system. In addition, the Plaintiff had already committed the LLC to SMR as their system manager before the investors had an option to consider managers. Significantly, the investors are not free to remove SMR as the manager. The current SMR contract runs for five years and is automatically renewable for an additional five years. SMR carefully worded the contract to only slightly give the investors any say in renewal. The investors had to agree not to unreasonably withhold their approval for renewal. SMR did not stop there. SMR added a tag line which has the clear intention to block any decision by the investors not to renew the contract by the language that a Court of competent jurisdiction must find SMR's conduct to be grossly negligent or amount to fraud. This Court following the instruction of the case law looks to the substance and not so much the form. *Rose v. Dobras*, 128 Ariz. at 212. In substance, the investors are not controlling the management.

The essential decisions involving the creation of the network, the selection of equipment, creating billing systems, recruiting customers, and raising capital are not in the hands of the investors and could not practically be made by so many investors.

This Court will not reassess the credibility of Mr. Hatfield or any other witness who testified before the ACC. The Court also recognizes that the record contains conflicting evidence on the issues set forth above. The standard for review of an administrative record is whether the decision was contrary to law, arbitrary or capricious, or an abuse of discretion. Since there is substantial evidence in the record to support the ACC decision, that decision is not arbitrary nor contrary to law. A.R.S. § 12-910(E); *Berenter v. Gallinger*, 173 Ariz. 75, 839 P.2d 1120 (App. 1992).

NUTEK INFORMATION SYSTEMS, INC., Jeffrey A. Shuken, Aks Daks Communications, Inc., Smr Advisory Group, L.C. and Albert Koenigsberg, Plaintiffs-Appellants,

v.

ARIZONA CORPORATION COMMISSION; Renz D. Jennings, Commissioner; Marcia Weeks, Commissioner and Carl J. Kunasek, Commissioner, Defendants-appellees.

No. 1 CA-CV 97-0590.

Court of Appeals of Arizona,
Division 1, Department E.

Nov. 5, 1998.

As Amended Nov. 10, 1998.
Review Denied May 25, 1999.

Law Practice of J.B. Grossman, P.A. by J.B. Grossman, Ft. Lauderdale, Florida and Roshka Heyman & DeWulf PLC by Paul J. Roshka, Randall H. Warner, Phoenix, for Plaintiffs-Appellants.

Grant Woods, Attorney General by W. Mark Sendrow, Assistant Attorney General, Robert A. Zumoff, Assistant Attorney General, Phoenix, for Defendants-Appellees.

Carol R. Goforth, Amicus Curiae Fayetteville, Arkansas and Lewis and Roca LLP by John P. Frank, Pamela B. Peterson, Phoenix, for Amicus Curiae.

OPINION

RYAN, Judge.

¶ 1 The Arizona Corporation Commission ("Commission") found that appellants violated Arizona securities laws by marketing membership interests in limited liability companies involved in telecommunications. This appeal challenges the Commission's conclusion that these interests constituted securities. We agree with the Commission and therefore affirm.

I.

¶ 2 Appellant, SMR Advisory Group, L.C., ("SMR") is a Texas limited liability company. Appellant, AKS DAKS Communications, Inc., ("ADC") is a Florida corporation. Appellant, Albert Koenigsberg, ("Koenigsberg") is the president and member-owner of SMR and the president and sole shareholder of ADC.

¶ 3 In the spring of 1994, Koenigsberg began forming and marketing interests in numerous limited liability companies ("LLC") formed in Texas. LLCs are unincorporated entities that have some characteristics of a general partnership and some characteristics of a corporation. Under Texas' LLC laws, neither members nor managers are liable for the LLC's obligations. Tex.Rev.Civ. Stat. Ann. art. 1528n § 4.03(A) (West 1997). An LLC may be managed by its members or by a manager.[1]

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[1] For more about this relatively new business entity, *see* Larry E. Ribstein & Robert R. Keatinge, Ribstein and Keatinge on Limited Liability Companies (1998); Robert R. Keatinge et al.,

¶ 4 The initial members of these LLCs consisted of SMR and individuals who owned 220-222 megahertz ("220 MHz") radio licenses from the Federal Communications Commission ("FCC"). The LLCs were organized to obtain licenses and construct, maintain, and operate five-channel 220 MHz dispatch communications systems. Appellants, Jeffrey Shuken ("Shuken") and his company, Nutek Information Systems, Inc., assisted Koenigsberg and SMR in soliciting additional members for these LLCs.

¶ 5 In telephone solicitations and written materials, appellants represented that the LLCs intended to enter into a cooperative operating relationship using compatible systems to form an integrated network, the Western Regional Network ("WRN"). The WRN would extend from Washington, south to California, and east into Nevada. Appellants claimed that the WRN would generate substantial revenue for the LLCs and provide services similar to cellular telephones.

¶ 6 On October 18, 1994, and again on November 7, Shuken spoke with Billy Oliverio, ("Oliverio") an investigator for the Arizona Corporation Commission. Shuken offered Oliverio an opportunity to invest in what he referred to as "Washington 220 Holdings, an L.L.C." Shuken later mailed Oliverio promotional offering materials similar to those sent to other prospective investors. The initial offering materials contained a signature page for the investor to reserve a specific number of units in a particular LLC at the offered rate per unit. Appellants

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The Limited Liability Company: A Study of the Emerging Entity, 47 BUS. LAW. 378, 401 (1992).

instructed investors to make their checks payable to the particular LLC and remit them to SMR. Some, but not all, of the signature pages informed the investor that SMR would send a Membership Summary at some time in the future, and the investor would have seven days after receipt to request a refund. Appellants collected over $10.4 million from approximately 920 investors, including $147,500 from seventeen Arizona residents.

¶ 7 SMR combined the investors' funds into a single administrative account and used the funds to purchase communications equipment and pay other expenses. SMR then charged the expenses to the respective LLCs. Koenigsberg was the sole signatory on this account.

¶ 8 While the appellants were soliciting investors in 1994, each LLC entered into a System Management Agreement with the FCC licensee who was an original member. Under this agreement, the LLC agreed to construct the communications system, manage the system, and administer invoicing and collection of customer accounts. The licensee retained ultimate control over operation of the system. Koenigsberg signed these agreements on behalf of the LLCs as "managing member." In some cases, he did so before the LLC was formally organized.

¶ 9 During this same period, each LLC also entered into a System Construction and Management Agreement with SMR. Under these agreements, SMR would obtain access to a system by negotiating contracts with FCC licensees, construct a system, maintain and manage it, and collect and receive payments on customer accounts.

The agreements recited that the licensees retained ultimate control. SMR was to receive as compensation 25 percent of gross operating revenues each month, with a minimum payment of $800 per month per channel ($4,000 per month for these five-channel systems). Each agreement lasted five years and contained a five-year renewal that could be refused by the LLC only if a court found SMR guilty of gross negligence or fraud. Koenigsberg executed the agreement on behalf of all entities: SMR, the LLCs as attorney in fact, and ADC as authorized agent.

¶ 10 On November 29, 1994, the Securities Division of the Arizona Corporation Commission initiated proceedings by filing a Notice of Opportunity for Hearing Regarding Proposed Order to Cease and Desist. The notice alleged violations of the registration and anti-fraud provisions of the Arizona Securities Act, Arizona Revised Statutes Annotated ("A.R.S.") sections 44-1801 to -2126.

¶ 11 In January 1995, the appellants sent the Membership Summary to investors who had previously reserved LLC units. This summary contained information on the following matters: risks; the relationship between the LLCs, ADC, and SMR; financial statements and organizational documents for the LLCs; and contractual arrangements between the LLCs, ADC, and SMR. It informed the investors that they could subscribe to the units previously reserved, or request a refund of the money they had already paid, but must do so within seven days. Appellants considered a failure to timely request a refund as consent to subscribe and a waiver of refund. A condition of subscribing required investors to ratify all prior acts of the LLC.

¶ 12 The Commission held a hearing in April 1995. It ruled that the membership interests marketed in the LLCs constituted securities and that the appellants had sold unregistered securities in violation of A.R.S. section 44-1841, failed to register as securities dealers or salesmen in violation of A.R.S. section 44-1842, and violated the anti-fraud provision, A.R.S. section 44-1991.

¶ 13 Appellants then filed this action, seeking judicial review of the Commission's decision. The superior court affirmed. Appellants appealed and we have jurisdiction. A.R.S. §§ 12-2101(B) and 12-913.

II.

¶ 14 This case presents a question of first impression in Arizona.[2] We must decide whether the membership interests in the LLCs constitute "securities," bringing them under the Arizona securities laws. Whether an instrument is a security is a question of law. *Vairo v.*

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[2] We are aware of only one other case where this issue has been considered: *S.E.C. v. Parkersburg Wireless Ltd. Liability Corp.*, 991 F.Supp. 6 (D.D.C.1997) (holding that membership interests in wireless cable limited liability company constituted securities). However, there has been some debate among legal scholars. Compare Carol R. Goforth, Why Limited Liability Company Membership Interests Should Not Be Treated as Securities and Possible Steps to Encourage this Result, 45 Hastings L.J. 1223 (1994) (concluding that LLC interests should not be considered securities); Mark A. Sargent, Are Limited Liability Company Interests Securities?, 19 Pepp. L.Rev. 1069 (1992) (same); with Marc I. Steinberg and Karen L. Conway, The Limited Liability Company as a Security, 19 Pepp. L.Rev. 1105 (1992) (concluding that such interests should generally be considered securities).

Clayden, 153 Ariz. 13, 18, 734 P.2d 110, 115 (App.1987); *Daggett v. Jackie Fine Arts, Inc.*, 152 Ariz. 559, 564, 733 P.2d 1142, 1147 (App.1986) (citing *United States v. Carman*, 577 F.2d 556, 562 (9th Cir.1978)). Our determination of the law, however, must be based on the facts determined by the factfinder in this case the Commission. *See Carman*, 577 F.2d at 562 ("[T]he ultimate issue of whether or not a particular set of facts, as resolved by the factfinder, constitutes an investment contract is a question of law.").

¶ 15 In reviewing the facts determined by an administrative agency, we do not reweigh the evidence. *Carondelet Health Servs. v. Arizona Health Care Cost Containment Sys. Admin.*, 182 Ariz. 502, 504, 897 P.2d 1388, 1390 (App.1995). We decide if substantial evidence supports the administrative decision, and we uphold that decision unless the administrative agency acted illegally, arbitrarily, capriciously, or abused its discretion. *Id.*

¶ 16 In Arizona, "security" is defined as:

> any note, stock, treasury stock, bond, commodity investment contract, commodity option, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas or other mineral rights, real property investment contract or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of,

or warrant or right to subscribe to or purchase, any of the foregoing.

A.R.S. § 44-1801(23). This definition is substantially similar to the definition of securities in both the Securities Act of 1933 and the Securities and Exchange Act of 1934. *See* Securities Act of 1933, 15 U.S.C.A. § 77(b)(a)(1) (1997); Securities Exchange Act of 1934, 15 U.S.C.A. § 78(c)(a)(10) (1997). Arizona courts therefore look to federal courts for guidance in interpreting the statute. *Vairo,* 153 Ariz. at 17, 734 P.2d at 114; *Rose v. Dobras,* 128 Ariz. 209, 211, 624 P.2d 887, 889 (App.1981). Here, we must determine whether the LLC membership interests constituted "investment contracts" under A.R.S. section 44-1801(23).

¶ 17 The Supreme Court has held that an investment contract is a security if a person (1) invests money (2) in a "common enterprise" and (3) is led to expect profits solely from the efforts of the promoter or a third party. *S.E.C. v. W.J. Howey Co.,* 328 U.S. 293, 301, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946); accord *Vairo,* 153 Ariz. at 17, 734 P.2d at 114; *Rose,* 128 Ariz. at 211, 624 P.2d at 889; *Daggett,* 152 Ariz. at 565, 733 P.2d at 1148. The Court has also noted that the definition of a security "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *Howey,* 328 U.S. at 299, 66 S.Ct. 1100; accord *Rose,* 128 Ariz. at 212, 624 P.2d at 890. Thus, substance controls over form.

¶ 18 Here, the parties agree that the first two prongs of the *Howey* test are satisfied and contest only the third element of the test, whether investors were led to expect profits based solely on the efforts of another. We note first that *Howey's* use of the term "solely" should not be taken literally. Rather, the third prong is satisfied if "the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." *S.E.C. v. Glenn W. Turner Enters. Inc.*, 474 F.2d 476, 482 (9th Cir.1973).[3]

¶ 19 The parties also agree that our analysis of the third prong should be guided by *Williamson v. Tucker*, 645 F.2d 404 (5th Cir.1981).[4] In *Williamson*, the Fifth Circuit addressed whether ownership interests in a general partnership (joint venture) could be considered securities. The court stated that usually general partners and joint venturers have enough control over their business entities that the third prong of the *Howey* test does not apply to them. *Id.* at 422-23. An investor who asserts that a general partnership interest constitutes an investment contract and therefore a security "has a difficult burden to overcome." *Id.* at 424. However, the burden is not insurmountable:

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[3] Accord *Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc.*, 840 F.2d 236, 240 n. 4 (4th Cir.1988); *S.E.C. v. Professional Assocs.*, 731 F.2d 349, 357 (6th Cir.1984); *Goodwin v. Elkins & Co.*, 730 F.2d 99, 103 (3d Cir.1984); *S.E.C. v. Aqua-Sonic Prods. Corp.*, 687 F.2d 577, 582 (2d Cir.1982); *Kim v. Cochenour*, 687 F.2d 210, 213 n. 7 (7th Cir.1982); *Williamson v. Tucker*, 645 F.2d 404, 418 (5th Cir.1981); *Aldrich v. McCulloch Properties, Inc.*, 627 F.2d 1036, 1040 n. 3 (10th Cir.1980); *Fargo Partners v. Dain Corp.*, 540 F.2d 912, 914-15 (8th Cir.1976); *see also International Bhd. of Teamsters, Chauffeurs, Warehousemen & Helpers of America v. Daniel*, 439 U.S. 551, 558, 99 S.Ct. 790, 58 L.Ed.2d 808 (1979) (stating that economic reality governs, rather than form, in deciding what is a security); *United Housing Found., Inc. v. Forman*, 421 U.S. 837, 848, 95 S.Ct. 2051, 44 L.Ed.2d 621 (1975) (same).

[4] Without extensive analysis, the court in *Parkersburg Wireless* cited *Williamson* in support of its conclusion that the membership interests in LLCs were securities. 991 F.Supp. at 8.

> It should be clear . . . however, that the mere fact that an investment takes the form of a general partnership or joint venture does not inevitably insulate it from the reach of the federal securities laws. All of these cases presume that the investor-partner is not in fact dependent on the promoter or manager for the effective exercise of his partnership powers. If, for example, the partner has irrevocably delegated his powers, or is incapable of exercising them, or is so dependent on the particular expertise of the promoter or manager that he has no reasonable alternative to reliance on that person, then his partnership powers may be inadequate to protect him from the dependence on others which is implicit in an investment contract.

Id. at 422-23. *Williamson* requires us to look beyond corporate form to the substance of the transaction in deciding whether the securities laws apply to it. Thus, the securities laws will apply when the transaction prevents the partners from effectively exercising their partnership powers.

¶ 20 The *Williamson* court set forth three factors which could demonstrate that a general partnership interest was a security:

> A general partnership or joint venture interest can be designated a security if the investor can establish, for example, that (1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the

> arrangement in fact distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.

Id. at 424. This list is not exhaustive; other factors may come into play.[5] Furthermore, these factors are not viewed in isolation; the transaction is considered as a whole. *Koch v. Hankins*, 928 F.2d 1471, 1476-78 (9th Cir.1991). Applying these three criteria to the facts determined by the Commission, we conclude that the membership interests marketed by appellants constituted investment contracts, and therefore securities, under Arizona law.

¶ 21 The Commission found that the agreements between the members, the LLCs, and ADC and SMR prevented members from exercising effective control over the LLCs. We agree.

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[5] The court stated:

> These are the only factors relevant to the issue that are at all implicated by the facts of this case. But this is not to say that other factors could not also give rise to such a dependence on the promoter or manager that the exercise of partnership powers would be effectively precluded.

Williamson, 645 F.2d at 424 n. 15; *see also Koch v. Hankins*, 928 F.2d 1471, 1477 n. 11 (9th Cir.1991).

¶ 22 In determining the level of investor control we look at both legal and practical control. *Id.* at 1478. We examine not only the formal agreement establishing the business enterprise (here, the LLCs' articles of organization), but also look to "other documents structuring the investment, to promotional materials, to oral representations made by the promoters at the time of the investment, and to the practical possibility of the investors exercising the powers they possessed pursuant to the [LLC] agreements." *Id.* "[R]eliance on others does not exist merely because the partners have chosen to hire another party to manage their investment." *Williamson*, 645 F.2d at 423.

¶ 23 Admittedly, the LLCs' articles of incorporation unambiguously provide that the member-investors had legal control. Indeed, they specifically state that "[t]he company is to be managed by its members." However, several factors worked against the members' ability to exercise effective control over the LLCs. First, the construction and management agreements turned over all principal management functions to SMR. These functions included location of FCC licenses and lease registration, initial construction of the system, maintenance of the constructed system, account administration, entry into all other necessary contractual relationships to operate the system, and development and implementation of plans to operate the system.[6] The agreements also delegated the responsibility of collecting and accounting for customer receipts to SMR and gave SMR control over those receipts.

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[6] We do not attach too much significance to the fact that the agreements specifically prohibited SMR Advisory from undertaking the following actions: borrowing money; incurring debts; purchasing, selling, leasing, trading, exchanging, or

¶ 24 Moreover, the members had little or no input in deciding to enter into these agreements because the agreements were already in place before most members were recruited to invest in their respective LLCs. The investors were required, as a condition of being accepted as a member, to ratify all previous acts of the LLC.

¶ 25 Finally, as a practical matter, the large number (920) of geographically dispersed investors and LLCs diluted partnership power to such an extent that it prevented the members from exercising effective control of the business. *See S.E.C. v. Telecom Marketing, Inc.*, 888 F.Supp. 1160, 1166 (N.D.Ga.1995) (stating the "number of partnership units sold so dilutes each partner's power that in actuality it appears none could exercise any meaningful partnership control"). We recognize that the mere number of members alone does not dispose of the question. However, when the role of members amounts only to the power to approve the management efforts of a third party precisely the proxy situation here[7] the

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otherwise disposing of LLC capital assets; making any FCC filings; and settling any legal action against the LLC. The other powers delegated to SMR Advisory appear to be the most significant ones as far as making the venture profitable.

[7] The membership interests provided that certain actions taken by SMR required membership approval which was solicited by a proxy vote of the membership. The Commission held that "[t]he proxy votes provided to investors in the respective LLCs provided the investors with illusory control because the actual management and administration of the respective LLCs had been contracted to ADC and SMR."

members are no different than shareholders. When taken together with the construction and management agreements, this situation ensured SMR would control the essential management functions that determined the failure or success of the LLCs. In effect, the transactions denied the members the legal control provided in the LLCs' articles of incorporation.

¶ 26 The Commission also found that the ordinary investor in this arrangement lacked the technical expertise to manage the LLCs and would therefore depend on the skills of SMR and Koenigsberg to manage them. With respect to this issue, both appellants and amicus argue that the second *Williamson* factor focuses on business acumen generally, and not on the specific enterprise in question. The Ninth Circuit has taken that approach. *See Koch,* 928 F.2d at 1479. However, the Fifth Circuit rejected this interpretation of its *Williamson* opinion:

> The test . . . refers to the investor's experience in "business affairs," without referring to specialized knowledge. In *Williamson,* however, our discussion made clear that the knowledge inquiry must be tied to the nature of the underlying venture. 645 F.2d at 423. In finding that the general partners in *Williamson* possessed the experience and expertise necessary to exercise their partnership powers, we emphasized the partners' prior experience in similar real estate ventures. *Id.* at 425. . . . *Williamson* . . . clearly requires that the investors' knowledge and experience be evaluated with reference to the nature of the underlying venture. Moreover, . . . any holding to the contrary would be inconsistent with *Howey* itself.

Long v. Shultz Cattle Co., 881 F.2d 129, 134 n. 3 (5th Cir.1989). Thus, *Long* interpreted *Williamson's* knowledge test as one requiring investors to have meaningful knowledge of the specific business being operated.

¶ 27 We adopt the Fifth Circuit's approach because we believe it better protects the intent behind the securities laws and takes account of the economic realities of the transaction. *See Tcherepnin v. Knight*, 389 U.S. 332, 336, 88 S.Ct. 548, 19 L.Ed.2d 564 (1967) (stating cases involving securities should be decided on the basis of the economic realities of the transaction). *Williamson's* three factor test is ultimately aimed at determining whether a person has been led to expect profits on the basis of the efforts of another. An investor's knowledge of the business being operated provides one of the most reliable indicators of that investor's ability to exercise control over the investment. When the investor does not possess specialized knowledge of the business, he or she is far more likely to expect profits based on the efforts of the promoter or manager. The securities laws are designed to protect less-than-prudent investors from giving their money to irresponsible or unscrupulous businessmen. Because investors without specialized knowledge of the business must rely on third parties to manage their investments, they are precisely the vulnerable investors the securities laws are designed to protect.

¶ 28 In addition, our reading of some Arizona decisions indicates that our courts have implicitly adopted this logic. For example, the venture involved in *Daggett v. Jackie Fine Arts* was held to be a security in part because the plaintiff who owned and operated a construction company had no experience in the marketing of fine art.

152 Ariz. at 567, 733 P.2d at 1150. Similarly, in *Sullivan v. Metro Productions, Inc.*, the investment scheme for marketing a video-taped television show was held to be a security because the "investments were offered without regard to the experience or sophistication of the investors in the television industry." 150 Ariz. 573, 577, 724 P.2d 1242, 1246 (App.1986). In short, just because one is a "business person" does not make him or her less reliant on the expertise of others when entering a new field of endeavor. We conclude that the second *Williamson* factor should focus on the individual investor's knowledge of the particular business being operated.

¶ 29 The evidence supports the Commission's decision that the investors did not possess the technical expertise to manage the LLCs. The Commission's expert, Dale Hatfield,[8] testified that an ordinary investor would have a "great deal of difficulty" in managing or operating the 220 MHz radio system. He further stated that it would have been hard for an investor to make informed decisions about some of the very technical issues involved. Hatfield also stated that any "network" idea would demand highly technical knowledge to coordinate and manage the system in terms of equipment, infrastructure, and operations. Finally, although a few investors had some experience in technical fields,[9] appellants did not contend that many or most of them had experience in running a dispatch radio communications business. Instead appellants argued that the members' ability to rely on one another's knowledge sufficed to satisfy Williamson's business knowledge requirement. We disagree.

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[8] The appellants argue that we should reject Hatfield's testimony because he lacked credibility. We reject this argument. In administrative appeals, the fact finder determines the credibility of witnesses, and we do not look over his shoulder. *See, e.g., Lathrop v. Arizona Bd. of Chiropractic Exam'rs,* 182 Ariz. 172, 181, 894 P.2d 715, 724 (App.1995); *Berenter v. Gallinger,* 173 Ariz. 75, 79, 839 P.2d 1120, 1124 (App.1992).

¶ 30 First, to the extent such an argument relies on the expertise provided by SMR and Koenigsberg, it fails. If we were to so hold, a promoter could avoid the securities laws simply by buying some of what he was selling. Second, such an argument analogizes an LLC to a general partnership and relies on the "strong presumption that an interest in a general partnership is not a security." *Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc.*, 840 F.2d 236, 241 n. 7 (4th Cir.1988). However, an LLC is not a general partnership, and we decline to give it the strong presumption that it is not a security. While general partnerships and LLCs do have common traits, they are different enough to warrant different treatment. As one commentator noted:

> The critical difference between LLCs and general partnerships is that the general partners' personal liability necessarily gives the partner an incentive to be highly informed about the business. At the same time, personal liability discourages involvement by unsophisticated investors. It follows that LLCs may have greater

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[9] Mark Lidke, an investor who testified on behalf of the appellants, had a technical background: he had degrees in chemical engineering and electrical engineering. He had made previous investments in wireless cable television and specialized mobile radio businesses.

> securities law exposure than general partnerships.

Robert R. Keatinge et al., The Limited Liability Company: A Study of the Emerging Entity, 47 BUS. LAW. 378, 404 (1992). Thus, the LLC member has less incentive to be informed about, or take an active role in, the business. This diminished incentive means the LLC members will actually be less likely to assist one another in the meaningful fashion anticipated by appellants. Given these inherent limitations in the LLC structure, we refuse to shift our analysis of investor knowledge from the individual to a group basis.

¶ 31 The Commission also found that the investors in the LLCs were so dependent on the unique entrepreneurial and managerial abilities of Koenigsberg, ADC, and SMR, that they were incapable of replacing them as managers, or of exercising meaningful powers of control. The evidence supports the Commission's finding.

¶ 32 First, the construction and management agreements made it almost impossible to replace SMR as manager. Under the contracts, the LLCs hired SMR for a term of five years, with options to continue the contract for unspecified additional five-year terms. The LLCs could only prevent SMR from exercising its option "for gross negligence or fraud as may be determined by a court of competent jurisdiction." Thus, the investors not only had "no reasonable replacement" for their manager, they in effect had no replacement. *See Koch,* 928 F.2d at 1480-81 (holding manager was irreplaceable where investors had no practical ability to replace him).

¶ 33 Second, the same contracts that prevented investors from replacing SMR also prevented investors from exercising meaningful control over the LLCs. Because the contracts provided that SMR would manage system construction, FCC licensing, customer accounts, and other operations critical to the success of the business, the investors would be irretrievably bound to the management decisions of SMR. In other words, the investors could not exercise meaningful control over LLC business operations.

¶ 34 Finally, the investors relied on SMR's managerial skills to combine the LLCs into a network. The promotional materials heavily touted the WRN as one of the chief revenue sources for the LLCs. Only the centralized management of SMR could make the WRN a viable business operation. The members depended on SMR to coordinate both the technical and financial aspects of the operation. This situation is similar to that in *Howey*:

> The respondent companies are . . . offering an opportunity to contribute money and to share in the profits of a large citrus fruit enterprise managed and partly owned by respondents. They are offering this opportunity to persons who reside in distant localities and who lack the equipment and experience requisite to the cultivation, harvesting and marketing of the citrus products. Such persons have no desire to occupy the land or to develop it themselves; they are attracted solely by the prospects of a return on their investment. Indeed, individual development of the plots of land that are offered and sold would seldom be economically feasible due to their small size. Such tracts gain utility as

> citrus groves only when cultivated and developed as component parts of a larger area. A common enterprise managed by respondents or third parties with adequate personnel and equipment is therefore essential if the investors are to achieve their paramount aim of a return on their investments.

328 U.S. at 299-300, 66 S.Ct. 1100; accord *Koch*, 928 F.2d at 1479-80 (although individuals investing in large-scale jojoba farm could technically replace their farm manager, it would not have been economical to do so); *Hocking v. Dubois*, 885 F.2d 1449, 1461 (9th Cir.1989) (similar, with reference to owners of individual condominium units in a resort). The *Koch* court summed up the difficulties faced by a hypothetical independent-minded individual in such a widespread endeavor:

> In this case, even if a general partner vigorously exercised his or her rights under the partnership agreement, he or she arguably could have no impact on the investment (other than to ensure its failure by withdrawing from the larger plantation).

928 F.2d at 1481. By contrast, in cases where the manager had only ministerial duties, the investors could more easily replace the manager, or the enterprise was limited in size, the courts have tended to find the interests were not securities. *See, e.g., Holden v. Hagopian*, 978 F.2d 1115, 1122-23 (9th Cir.1992) (finding that manager could be fired at any time, "with or without cause"; reasonable replacements were available; lack of "pooling" of resources lessened the need for centralized management); *Rivanna Trawlers*, 840 F.2d at 242 (finding that investors could, and did, replace the managers).

¶ 35 Like the investors in *Howey*, the investors in this case could only achieve promised network profits from the coordinated management of the geographically dispersed LLCs. The construction and management contracts ratified by investors as a condition of membership stated that this coordinated management would be provided by SMR. Thus, to a large extent the financial success of the LLCs as advertised to prospective investors depended on the managerial skills only SMR could provide.

¶ 36 In sum, the evidence supported the Commission's findings that the *Williamson* factors had been met. The agreements between investors and the LLCs placed most of the managerial power in the hands of Koenigsberg, ADC, and SMR. Additionally, the highly technical nature of the 220 MHz radio-dispatch system ensured that few investors would possess the specific business knowledge necessary to make informed decisions about critical management functions. Finally, the construction and management contracts prevented SMR's removal as a manager and, when combined with the financial and technical issues, effectively prevented LLC members from exercising meaningful control over their investments. As a result, LLC members were dependent on the efforts of Koenigsberg, ADC, and SMR for the financial success of the business. Accordingly, the membership interests constituted investment contracts and were securities under A.R.S. section 44-1801(23).

¶ 37 In addition to arguing that the membership interests did not constitute securities, appellants argued that the evidence did not support the Commission's findings. To the extent these arguments address facts touching upon whether the membership interests constituted securities, we have already stated that the evidence supported the Commission's findings. Appellants also argued, however, that the evidence did not support the Commission's finding that appellants committed fraud under A.R.S. section 44-1991. We disagree.

¶ 38 To establish fraud, section 44-1991 required the Commission to find that appellants made untrue statements of material fact, omitted material facts, or engaged in transactions or business practices that operated as a fraud or deceit. The Commission made twelve specific findings meeting these criteria including that appellants: (1) had failed to inform investors of the risks before investing; (2) misrepresented 220 MHz radio as a "poor man's cellular;" (3) had touted the WRN as a profit source; and (4) had failed to inform investors of regulatory actions which could affect the value of the investment. Appellants take issue with these findings for various reasons.

¶ 39 Appellants first claim that the findings concerning the disclosure of the technical risks and the feasibility of the WRN rested on the Commission's expert Dale Hatfield, whose testimony appellants claim was unreliable. As noted earlier, we cannot reweigh the evidence or reassess the credibility of witnesses. *Carondelet Health Servs.,* 182 Ariz. at 504, 897 P.2d at 1390; *Berenter v. Gallinger,* 173 Ariz. 75, 79, 839 P.2d 1120, 1124 (App.1992). Thus, to the extent these findings rely on Hatfield's testimony they are adequately supported by the evidence.

¶ 40 Appellants also complain that the membership summary, provided to investors several months after their investment and shortly after the State filed its notice to cease and desist, adequately informed investors of the risks associated with the transaction. The evidence indicates otherwise. While it is true the summary described the substantial hurdles the LLCs would face before turning a profit, they did not correct the earlier misrepresentations that induced the investors to invest. Most importantly, the summary still held out the idea of the WRN and likened the 220 MHz radio-dispatch to cellular phone communications.[10]

¶ 41 Finally, appellants complain that contradictory evidence was presented regarding the investors' knowledge of regulatory action occurring in other states. While this is true, we are bound by the fact finder's resolution of contradictory evidence. *See Berenter,* 173 Ariz. at 77, 839 P.2d at 1122 (declining to address appellant's arguments based on contradictory evidence). Accordingly, we hold that the Commission's finding that appellants committed fraud under A.R.S. section 44-1991 was adequately supported by the evidence.

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[10] Expert testimony at the hearing revealed the substantial differences between cellular service and the 220 MHz radio-dispatch system. 220 MHz radio is half-duplex, meaning only one person can talk at a time; while cellular service is full-duplex where both parties can speak at the same time. In addition, 220 MHz communications systems are more expensive than cellular systems because cellular companies subsidize the purchase of telephone equipment. Finally, at the time of investment, no portable cellular-like equipment was available to take advantage of the 220 MHz frequency range.

III.

¶ 42 We do not hold that a membership interest in any limited liability company constitutes a security; that question must be answered on a case-by-case basis. We do hold that the membership interests in the limited liability companies involved here were securities as defined by the Arizona securities laws. Therefore, we affirm the judgment.

THOMAS C. KLEINSCHMIDT, Judge and CECIL B. PATTERSON, Jr., Judge, concur.

(LOGO)

Supreme Court

STATE OF ARIZONA

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May 26, 1999

RE: **NUTEK INFORMATION SYSTEMS, INC./JEFFREY A. SHUKEN et al vs. AZ CORPORATION COMM/RENZ JENNINGS/MARCIA WEEKS/CARL KUNASEK**
Supreme Court No. CV-98-0548-PR
Court of Appeals No. 1 CA-CV 97-0590
Maricopa County No. CV 96-20499

GREETINGS:

The following action was taken by the Supreme Court of the State of Arizona on May 25, 1999, in regard to the above-referenced cause:

ORDERED: Petition for Review = DENIED.

Record returned to Court of Appeals, Division One, Phoenix, this 26th day of May, 1999.

NOEL K. DESSAINT, Clerk

TO:
J.B. Grossman, Esq., Law Practice of J.B. Grossman
Paul J. Roshka, Esq. and Randall H. Warner, Esq., Roshka Heyman & DeWulf PLC
Hon. Janet Napolitano, Attorney General
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ARIZONA REVISED STATUTES ANNOTATED
TITLE 44. TRADE AND COMMERCE
CHAPTER 12. SALES OF SECURITIES
ARTICLE 4. SALE OF SECURITIES

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Current through End of the 1998 2nd Regular Session and the 6th Special Session

§ 44-1843. Exempt securities; fee; filing

A. The provisions of §§ 44-1841, 44-1842 and 44-3321 do not apply to any of the following classes of securities:

1. Securities issued or guaranteed by the United States, or by any state, territory or insular possession thereof, or by any political subdivision of such state, territory or insular possession, or by the District of Columbia, or by any agency or instrumentality of one or more of any of the foregoing. This exemption shall not apply to securities regulated pursuant to § 44-1843.01.

2. Securities issued by a national bank, a bank or a credit or loan association organized pursuant to an act of Congress and supervised by the United States or an agency thereof, or issued by a state bank or savings institution the business of which is supervised and regulated by an agency of this state or of the United States.

3. Securities issued by a savings and loan association subject to supervision by an agency of this state.

4. Insurance or endowment policies, annuity contracts or optional annuity contracts issued by a person subject to the supervision of and licensed by the insurance commissioner, the bank commissioner or any agency of the United States, any state or the District of Columbia performing like functions.

5. Securities issued or guaranteed either as to principal, interest or dividend by a railroad or public utility if the issuance of its securities is regulated by an agency of the United States, a state, territory or insular possession thereof, an agency of the District of Columbia, or an agency of the Dominion of Canada or any province thereof, and also equipment trust certificates in respect to equipment conditionally sold or leased to a railroad or public utility, if other securities issued by such railroad or public utility would be exempt under this paragraph.

6. Securities issued by a corporation organized and operated exclusively for religious, educational, benevolent, fraternal, charitable or reformatory purposes and not for pecuniary profit, and no part of the net earnings of which inures to the benefit of any private stockholder or individual, excluding, however, securities made liens upon revenue producing property subject to taxation and securities other than pooled income funds or units of pooled income funds under § 642(c)(5) of the internal revenue code[1] issued by a nonprofit organization which is engaged in, intends to engage in, controls, finances, or lends funds or property to other entities engaged in the construction, operation, maintenance, or management of a hospital, sanitarium, rest home, clinic, medical hotel, mortuary, cemetery, mausoleum or other similar facilities.

7. Securities listed or approved for listing upon the issuance thereof upon the New York stock exchange, the American stock exchange, the midwest stock exchange or any other national securities exchange registered under the securities exchange act of 1934[2] which is designated by the commission as provided in this paragraph, and securities designated or approved for designation on

notice of issuance on the national market system of a national securities association registered under the securities exchange act of 1934, and all securities senior or equal in rank to any securities so listed or approved for listing, designated or approved for designation or represented by subscription rights or warrants which have been so listed, designated or approved and any warrant or right to purchase or subscribe to any of the foregoing. In addition to the securities exchanges prescribed in this paragraph, the commission may by order designate any registered national securities exchange if it finds that it would be in the public interest for securities listed thereon to be exempt. The commission may at any time by order withdraw a designation of an exchange or association made under this paragraph.

8. Commercial paper which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, which evidences an obligation to pay cash within nine months of the date of issuance or sale, exclusive of days of grace, or any renewal of such paper which is likewise limited, or any guarantee of such paper or of any such renewal.

9. Securities issued or guaranteed by any foreign government with which the United States is at the time of the sale maintaining diplomatic relations, or securities issued or guaranteed by a political subdivision of such foreign government having the power of taxation, if none of the securities of the foreign government or political subdivision are in default either as to principal or interest, and which securities when offered for sale in this

state are acknowledged as valid obligations by the foreign government or political subdivision and registered under the securities act of 1933.[3]

10. Notes or bonds secured by a mortgage or deed of trust on real estate or chattels, or a contract or agreement for the sale of real estate or chattels, if the entire mortgage, contract or agreement together with all notes or bonds secured thereby is sold or offered for sale as a unit, except for real property investment contracts.

11. Mortgage related securities, as defined in § 3(a)(41) of the securities exchange act of 1934.[4]

B. Issuers of securities that are exempt under subsection A, paragraphs 6, 7 and 9 of this section, within thirty days after the first sale of the securities in this state, shall pay to the commission a fee of two hundred dollars for each offering, and the commission shall deposit the fees in the commerce and economic development commission fund established in § 41-1505.10.

C. Any securities that are offered and sold pursuant to § 4(5) of the securities act of 1933 or that are mortgage related securities as the term is defined in § 3 (a)(41) of the securities exchange act of 1934[5] are not preempted by federal law. These instruments, commonly referred to as private mortgage backed securities, may be exempt from the registration requirements of this chapter if the transaction or the securities are otherwise exempt under this chapter. This subsection specifically overrides the preemption of state law contained in § 106(c) of the secondary mortgage market enhancement act of 1984 (P.L. 98-440).

D. Noncompliance with the requirements in subsection B of this section to pay fees shall not result in the loss of the exemption allowed by this section.

A.R.S. § 44-1843.01

ARIZONA REVISED STATUTES ANNOTATED
TITLE 44. TRADE AND COMMERCE
CHAPTER 12. SALES OF SECURITIES
ARTICLE 4. SALE OF SECURITIES

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§ 44-1843.01. Nonexempt government securities; exemptions

A. Notwithstanding the provisions of § 44-1843, paragraph 1, the provisions of §§ 44-1841 and 44-1842 shall apply to the following classes of securities unless the requirements of subsection B of this section are met:

1. Any obligations or securities which are industrial development bonds as defined in § 103 of the United States internal revenue code of 1954, as amended, with no exception for the small issue exemptions contained in § 103 (b)(6) or 103 (d),[1] except that the provisions of this paragraph shall not apply to any issue where substantially all of the proceeds are to be used to provide residential real property for family units, airports, docks, wharves, mass commuting facilities, parking facilities, sewage or solid waste disposal facilities, air or water pollution control facilities, or facilities for the furnishing

of water if available on reasonable demand to members of the general public.

2. Bond anticipation notes authorized pursuant to title 48, chapter 6, article 1.[7]

3. Improvement district bonds authorized pursuant to title 48, chapter 6, article 2.[8]

4. Bonds of issuers located outside the state secured only by special assessments.

5. Securities of public subdivisions used to provide monies to finance the acquiring, constructing, improving, equipping or furnishing of medical office buildings, sanitariums, clinics, medical hotels, mortuaries, cemeteries, mausoleums, rest homes, nursing homes, skilled nursing facilities or other similar facilities for use by corporations or entities other than municipal which bonds or notes are not fully secured by payments to be made by an entity owning or operating, repurchasing or leasing a hospital from a political subdivision.

B. The provisions of §§ 44-1841 and 44-1842 shall not apply to the securities to which subsection A of this section applies if the following conditions are met:

1. With respect to the nongovernmental entity responsible for making the payments pledged to repay the obligations, there shall be filed with the commission a notice of the proposed offering, the trust indenture, if any, a two hundred dollar filing fee and an official statement or prospectus which includes the financial disclosures required by § 44-1894. The filing shall be by the nongovernmental user with respect to obligations to which subsection A, paragraphs 1 and 5 of this section

apply and by the underwriter or dealer with respect to obligations to which subsection A, paragraph 2, 3 or 4 of this section applies. The trust indenture, official statement or prospectus may be filed in draft form if substantially complete. In the case of special assessment bonds to which this section applies, the commission may waive the requirement for filing an official statement or prospectus, modify the information to be contained in the official statement or prospectus or permit the filing of information concerning the bonds in lieu of an official statement or prospectus. The notice, among other things, shall include a statement as to whether a rating on the securities will be sought and from whom the rating will be sought.

2. Upon the receipt of the notice and official statement or prospectus, the exemption shall be effective within twenty days, or less than twenty days if accelerated by order of the director for good cause shown. The exemption shall not become effective if, within such twenty-day period, the commission issues an order to show cause why the exemption should not be denied. If such order to show cause is issued, the applicant shall be given notice and opportunity to be heard pursuant to article 11 of this chapter.[4] The commission may deny an exemption if it finds that the official statement or prospectus is incomplete, inaccurate or misleading.

A.R.S. § 44-1843.02

ARIZONA REVISED STATUTES ANNOTATED
TITLE 44. TRADE AND COMMERCE
CHAPTER 12. SALES OF SECURITIES
ARTICLE 4. SALE OF SECURITIES

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§ 44-1843.02. Special filing requirements for certain exempt securities

Any advertising and sales material, other than notices required by law to be published or posted, used in connection with offers or sales to the public of any of the securities to which § 44-1843.01, subsection A applies shall be filed with the securities division three days prior to its proposed use. The filing required by this section shall be made by the nongovernmental user, dealer or underwriter.

A.R.S. § 44-1971

ARIZONA REVISED STATUTES ANNOTATED
TITLE 44. TRADE AND COMMERCE
CHAPTER 12. SALES OF SECURITIES
ARTICLE 11. HEARINGS

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§ 44-1971. Initiation of hearing; purpose of hearing

Hearings may be ordered by the commission upon its own initiative or at the written request of any interested person, either before or after registration of securities, dealers or salesmen:

1. For the purpose of administering or obtaining information necessary in the enforcement of this chapter or the rules, regulations or orders of the commission thereunder.

2. To enable the commission to take appropriate action in connection with any pending application for registration of any securities, dealer or salesman.

3. To modify the terms and conditions of any registration.

4. To determine whether the registration of any securities or of any dealer or salesman should be denied, suspended or revoked.

A.R.S. § 44-1801

ARIZONA REVISED STATUTES ANNOTATED
TITLE 44. TRADE AND COMMERCE
CHAPTER 12. SALES OF SECURITIES
ARTICLE 1. DEFINITIONS

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§ 44-1801. Definitions

In this chapter and chapter 13 of this title,[10] unless the context otherwise requires:

1. "Blind pool offering" means an offering in which either: (a) The offering materials do not describe specific operational plans. (b) Eighty per cent or more of the net offering proceeds are not specifically allocated for the purchase, construction, or development of identified property or products, for the payment of indebtedness or overhead expenses, or for other activities set forth in the issuer's business plan.

2. "Commission" means the Arizona corporation commission.

3. "Commodity" means any agricultural, grain or livestock product or by-product, any metal or mineral including a precious metal, any gem or gemstone whether characterized as precious, semiprecious or otherwise, any fuel whether liquid, gaseous or otherwise, any foreign currency and all other goods, articles, products or items of any kind. Commodity does not include a numismatic coin with a fair market value at least fifteen per cent higher than the value of the metal it contains, real property or any timber, agricultural or livestock product

grown or raised on real property and offered or sold by the owner or lessee of such real property, or any work of art offered or sold by art dealers, at public auction or offered or sold through a private sale by the owner.

4. "Commodity exchange act" means the act of Congress known as the commodity exchange act (7 United States Code, chapter 1).

5. "Commodity futures trading commission" means the independent regulatory agency established by Congress to administer the commodity exchange act.

6. "Commodity investment contract" means any account, agreement or contract for the purchase or sale, primarily for speculation or investment purposes and not for use or consumption by the offeree or purchaser, of one or more commodities, whether for immediate or subsequent delivery or whether delivery is intended by the parties, and whether characterized as a cash contract, deferred shipment or deferred delivery contract, forward contract, futures contract, installment or margin contract, leverage contract or otherwise. Any commodity investment contract offered or sold, in the absence of evidence to the contrary, is presumed to be offered or sold for speculation or investment purposes. A commodity investment contract does not include any contract or agreement which requires, and under which the purchaser receives, within twenty-eight calendar days after the payment in good funds of any portion of the purchase price, physical delivery of the total amount of each commodity to be purchased under the contract or agreement.

7. "Commodity option" means any account, agreement or contract giving a party to the account, agreement

or contract the right but not the obligation to purchase or sell one or more commodities or one or more commodity investment contracts, whether characterized as an option, privilege, indemnity, bid, offer, put, call, advance guaranty, decline guaranty or otherwise.

8. "CRD system" means the central registration depository system of the national association of securities dealers, incorporated.

9. "Dealer":

(a) Means a person who directly or indirectly engages full-time or part-time in this state as agent, broker or principal in the business of offering, buying, selling or otherwise dealing or trading in securities issued by another person, and who is not a salesman for a registered dealer or is not a bank or savings institution the business of which is supervised and regulated by an agency of this state or the United States.

(b) Means an issuer, other than an investment company, who, directly or through an officer, director, employee or agent who is not registered as a dealer under this chapter, engages in selling securities issued by such issuer.

(c) Does not include a person who sells or offers to sell securities exclusively to dealers registered under this chapter, and who has no place of business within this state.

(d) Does not include a person who buys or sells securities for his own account, either individually or in a fiduciary capacity, but not as part of a regular business.

10. "Director" means the director of the securities division of the commission.

11. "Federal covered security" means any security described as a covered security in § 18 of the securities act of 1933.

12. "Issuer" means any person who issues or proposes to issue any security, except:

(a) With respect to certificates of deposit, voting-trust certificates, collateral-trust certificates, certificates of interest or shares in an unincorporated investment trust, whether or not of the fixed, restricted management, or unit type, issuer means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued.

(b) With respect to equipment-trust certificates or like securities, issuer means the person by whom the equipment or property is or is to be used.

(c) With respect to fractional interests in any oil, gas or other mineral lease, permit, claim or right, issuer means the owner thereof or of any interest therein, whether whole or fractional, fractional interests in which are created for the purpose of a public offering.

13. "Offer to sell" or "offer for sale" means an attempt or offer to dispose of, or solicitation of an order or offer to buy, a security or interest in a security for value or any sale or offer for sale of a warrant or right to subscribe to another security of the same issuer or of another issuer. Any sale or offer for sale of a security

which gives the holder thereof a present or future right or privilege to convert such security into another security of the same issuer or of another issuer shall be deemed an offer to sell the security to be acquired pursuant to such right or privilege, but the existence thereof shall not be construed as affecting the registration or exemption under this chapter of the security to which it attaches.

14. "Person" means an individual, corporation, partnership, association, joint stock company or trust, or any other unincorporated organization.

15. "Precious metal" means the following in either coin, bullion or other form:

(a) Silver.

(b) Gold.

(c) Platinum.

(d) Palladium.

(e) Copper.

16. "Real property investment contract" means a contract for the sale or purchase of a promissory note secured directly or collaterally by a mortgage, deed of trust or other lien on real property, including a contract as defined by § 33-741, or any agreement, arrangement or understanding in connection with such note, lien or contract in which a person agrees, implies to do or does any of the following, whether or not the investor is aware that any of the following actions are contemplated or taken:

(a) Guarantee the note, lien or contract against loss at any time.

(b) Promise to provide a market for the sale of the note, lien or contract, in connection with a sale or purchase.

(c) Offer to accept or accept funds for investment in notes or contracts secured directly or indirectly by a lien on real property, where the real property is unspecified at the time of investment.

(d) Pay any interest or premium for a period before actual purchase and delivery of the note or contract.

(e) Pay any money to an investor if the note or contract is in arrears.

(f) Guarantee that principal or interest will be paid in conformity with the terms of the note or contract.

(g) Accept, from time to time, partial payment toward the purchase of the note or contract.

(h) Promise to repurchase the note or contract, in connection with sale or purchase.

17. "Registered dealer" means a dealer registered under this chapter.

18. "Registered salesman" means a salesman registered under this chapter.

19. "Sale" or "sell" means a sale or any other disposition of a security or interest in a security for value, and includes a contract to make such sale or disposition. A security given or delivered with, or as a bonus on account of, a purchase of securities or other thing shall be conclusively presumed to constitute a part of the subject of the purchase and to have been sold for value.

20. "Salesman" means an individual, other than a dealer, employed, appointed or authorized by a dealer to sell securities in this state. The partners or executive officers of a registered dealer shall not be deemed salesmen within the meaning of this definition.

21. "Securities act of 1933" means the act of Congress known as the securities act of 1933.[11]

22. "Securities exchange act of 1934" means the act of Congress known as the securities exchange act of 1934.[12]

23. "Security" means any note, stock, treasury stock, bond, commodity investment contract, commodity option, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas or other mineral rights, real property investment contract or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

24. "SRD system" means a securities registration depository system established to receive electronic filings of securities offerings.

25. "Underwriter" means a person who has acquired from an issuer with a view to, or sells for an

issuer in connection with, the distribution of any securities or participates or has a direct or indirect participation in such undertaking, or participates or has a participation in the direct or indirect underwriting of such undertaking. Underwriter shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributor's or seller's commission.

A.R.S. § 44-1841

ARIZONA REVISED STATUTES ANNOTATED
TITLE 44. TRADE AND COMMERCE
CHAPTER 12. SALES OF SECURITIES
ARTICLE 4. SALE OF SECURITIES

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Current through End of the 1998 2nd Regular Session and the 6th Special session

§ 44-1841. Sale of unregistered securities prohibited; classification

A. It is unlawful to sell or offer for sale within or from this state any securities unless such securities have been registered by description under §§ 44-1871 through 44-1875 or registered by qualification under §§ 44-1891 through 44-1902 or are securities for which a notice filing has been made under § 44-3321, except securities exempt under § 44-1843 or 44-1843.01 or securities sold in exempt transactions under § 44-1844.

B. A person violating this section is guilty of a class 4 felony.

A.R.S. § 44-1842

ARIZONA REVISED STATUTES ANNOTATED
TITLE 44. TRADE AND COMMERCE
CHAPTER 12. SALES OF SECURITIES
ARTICLE 4. SALE OF SECURITIES

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§ 44-1842. Transactions by unregistered dealers and salesmen prohibited; classification

A. It is unlawful for any dealer to sell or purchase or offer to sell or buy any securities, or for any salesman to sell or offer for sale any securities within or from this state unless the dealer or salesman is registered as such pursuant to the provisions of article 9[8] of this chapter.

B. A person violating this section is guilty of a class 4 felony.

A.A.C. R14-4-308

Ariz. Admin. Code R14-4-308

ARIZONA ADMINISTRATIVE CODE
TITLE 14. PUBLIC SERVICE CORPORATIONS; CORPORATIONS AND ASSOCIATIONS;
SECURITIES REGULATION
CHAPTER 4. CORPORATION COMMISSION – SECURITIES
ARTICLE 3. PROVISIONS RELATING TO ENFORCEMENT
Current through December 31, 1998

R14-4-308. Rescission and Restitution

A. Where there has been a violation of the Securities Act or the IM Act, or any rule or order of the Commission, the person or persons responsible for the violation may be required, pursuant to the Securities Act or the IM Act, to make rescission and/or restitution as provided herein.

B. Where a rescission offer is ordered by the Commission,

1. The following materials must be filed with and receive prior approval from the Director before distribution to the purchasers:

a. A written offer to repurchase stating in reasonable detail the facts out of which liability arose and, in the event of a violation of A.R.S. §§ 44-1991, 44-1992, or 44-3241, the correct, true, or omitted facts.

b. An offer to repurchase the security shall include an offer of:

i. Cash (or, if the Commission determines it is in the public interest, other property) equal to the fair market value of the consideration paid (determined as of the date such payment was originally paid by the buyer) or such lesser amount as shall be ordered by the Commission (if it determines that it is in the public interest to order such lesser amount); together with

ii. Such amount or rate of interest as shall be ordered by the Commission for the period from the date of purchase payment to the date of repayment; less

iii. The amount of any principal, interest, or other distributions received on the security for the period from the date of purchase payment to the date of repayment.

c. The offer to repurchase shall be accompanied by a prospectus and other documents making full written disclosure about the financial and business condition of the issuer and the financial and business risks associated with the retention of the securities and contain any such further information as the Commission may require.

d. The offer to repurchase shall state that such offer may be accepted by the purchaser at any time within a specified period of not less than 30 days after the date of receipt thereof unless a shorter period of time is ordered by the Commission.

2. The offer and any other materials required to be presented to the purchaser shall be made within a period specified by the Commission.

3. Financial statements prepared in accordance with R14-4-120, A.R.S. § 44-3159, or other appropriate documentation as requested by the Director or the Commission, shall be provided to the Director. The financial

statements or documentation shall demonstrate that the person or persons funding the rescission offer has or have adequate funds to pay the amount ordered pursuant to subsection (13)(1)(b) to all purchasers of the securities who are eligible to accept the rescission offer. The funding of the rescission offer may be provided by the seller, issuer, or other 3rd party.

4. The Commission may order that funds be deposited in escrow as the Commission deems necessary.

5. When the rescission offer has been completed and the appropriate funds paid, the person funding the rescission offer must verify to the Director that the rescission offer was made in accordance with this rule. The verification may be performed by an independent 3rd party, such as an accountant or escrow agent, and by providing the pertinent records documenting the rescission offer to the Director. The following information must be included unless otherwise ordered by the Commission:

a. Names, addresses, and telephone numbers of all securities holders of the issuer who had a right to receive the rescission offer, the amount and purchase dates of securities held by such securities holders, and the amount of principal, interest, or other distributions on all securities held by such securities holders;

b. Names, addresses, and telephone numbers of all securities holders of the issuer who did not receive the rescission offer and the reason why they did not receive the rescission offer, the amount and purchase dates of securities held by such securities holders, and the amount of principal, interest, or other distributions on all securities held by such securities holders;

c. Verification of receipt of the rescission offer by all securities holders who had a right to and did receive the rescission offer;

d. A list of securities holders who accepted the rescission offer and those who did not accept;

e. Verification of payment of principal and interest ordered to be paid to all such securities holders who accepted the rescission offer.

C. Where restitution is ordered by the Commission,

1. The amount payable as damages to each purchaser shall include the amount computed under subsection (B)(1)(b) less the amount of any sale proceeds received on disposal of the security if it was sold at any time by the purchaser.

2. Financial statements prepared in accordance with R14-4-120, A.R.S. § 44-3159, or other appropriate documentation as requested by the Director or the Commission, shall be provided to the Director. The financial statements or documentation shall demonstrate that the person paying restitution has adequate funds to pay all purchasers the amount computed in subsection (C)(1).

3. The Commission may order that funds be deposited in escrow as the Commission deems necessary.

4. The Commission may order the respondent to provide the following information to the Division:

a. Names, addresses, and telephone numbers of all securities purchasers who had a right to receive restitution under the Commission's order; amount and purchase dates of securities purchased by such purchasers;

fair market value of any non-cash consideration received by respondent from each purchaser of such securities; and any payment of principal, interest, or any other distribution on such security.

b. Verification of payment of principal and interest ordered to be paid to all such purchasers.

A.R.S. § 44-1844

ARIZONA REVISED STATUTES ANNOTATED
TITLE 44. TRADE AND COMMERCE
CHAPTER 12. SALES OF SECURITIES
ARTICLE 4. SALE OF SECURITIES

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§ 44-1844. Exempt transactions

A. Except as provided in subsections B and C of this section, the provisions of §§ 44-1841, 44-1842 and 44-3321 do not apply to any of the following classes of transactions:

1. Transactions by an issuer not involving any public offering.

2. The sale of securities by an executor, administrator, guardian or conservator or by a bank the business of which is supervised and regulated by an agency of this state or of the United States, as trustee under a will or trust agreement, or by a receiver or trustee in insolvency or bankruptcy approved by a court of competent jurisdiction of this state or the United States.

3. The sale in good faith and not for the purpose of avoiding the provisions of this chapter by a pledgee of securities pledged for a bona fide debt.

4. The sale in good faith and not for the purpose of avoiding the provisions of this chapter of securities by the bona fide owner of such securities, other than an issuer or underwriter, in an isolated transaction, in which the securities are sold either directly or through a dealer

as agent for the owner but where the sales are not made in the course of repeated or successive transactions of similar character by the owner and are not made directly or indirectly for the benefit of the issuer or an underwriter of the securities.

5. The distribution by a corporation of capital stock or other securities to its stockholders or other security holders as a stock dividend or other distribution out of retained earnings.

6. Any transaction or series of transactions incident to a statutory or judicially approved reorganization, merger, triangular merger, consolidation, or sale of assets, incident to a vote by securities holders pursuant to the articles of incorporation, the applicable corporate statute or other controlling statute, a partnership agreement or the controlling agreement among securities holders.

7. The exchange of securities by an issuer with its existing security holders exclusively, where no commission or remuneration is paid or given, directly or indirectly, for soliciting the exchange, if such exchange has been duly authorized and has been approved by the holders of not less than a majority of the outstanding securities of each class affected by the exchange.

8. The sale of securities to a bank, a savings institution, an insurance company, a dealer or an agency or instrumentality of the United States or of a state or to a person a principal part of whose business consists of buying securities.

9. The issuance and delivery of securities in exchange for other securities of the same issuer pursuant

to a right of conversion entitling the holder of the securities surrendered in exchange to make such conversion.

10. The issuance and delivery of securities of a corporation to the original incorporators, not exceeding ten in number, where the securities are not acquired by the incorporators for the purpose of sale to others and are not directly or indirectly sold to a third party within twenty-four months unless an incorporator experiences a bona fide change of financial circumstances within such time period, providing original incorporators are notified of their right pursuant to title 10[14] to review the financial books and records of the corporation at reasonable times.

11. A nonissuer transaction in an outstanding security, including the sale by a dealer, including an underwriter no longer acting as an underwriter in respect to the securities involved, of securities sold and distributed to the public, but not including securities constituting an unsold allotment to or subscription by the dealer as a participant in the distribution of the securities by the issuer or by or through an underwriter, if the class of security has been outstanding in the hands of the public for not less than ninety days preceding the date of the transaction and a recognized manual of securities designated by the commission by rule or order at the time of sale contains the names of the issuer's officers and directors, a statement of financial condition of the issuer as of a date within eighteen months of the date of the sale and a statement of income or operations for each of the two fiscal years next before the date of the statement of financial condition or for the period from the commencement of the issuer's existence to the date of the statement of financial condition if the period is less than two years.

12. The sale by a dealer, including an underwriter no longer acting as an underwriter in respect to the securities involved, of securities of an issue sold and distributed to the public, but not including securities constituting an unsold allotment to or subscription by the dealer as a participant in the distribution of the securities by the issuer or by or through an underwriter, if securities of such issue have been registered by description under §§ 44-1871 through 44-1875 or registered by qualification under §§ 44-1891 through 44-1902.

13. The sale of commodity investment contracts traded on a commodities exchange recognized by the commission at the time of sale.

14. The sale or issuance of any investment contract or other security in connection with an employee's pension, profit sharing, stock purchase, stock bonus, savings, thrift, stock option or other similar employee benefit plan which meets the requirements for qualification under the United States internal revenue code.[15]

15. Transactions within the exclusive jurisdiction of the commodity futures trading commission as granted under the commodity exchange act.

16. Transactions involving the purchase of one or more precious metals which require, and under which the purchaser receives, within seven calendar days after the payment in good funds of any portion of the purchase price, physical delivery of the quantity of the precious metals purchased by such payment. For the purposes of this paragraph, physical delivery is deemed to have occurred if, within such seven day period, the quantity of precious metals purchased by such payment is delivered,

whether in specifically segregated or fungible bulk form, into the possession of a depository other than the seller which is a financial institution, a depository the warehouse receipts of which are recognized for delivery purposes for any commodity on a contract market designated by the commodity futures trading commission or a storage facility licensed or regulated by the United States or any agency of the United States and such depository or other person that qualifies as a depository issues and the purchaser receives a certificate, document of title, confirmation or other instrument evidencing that such quantity of precious metals has been delivered to the depository and is being and will continue to be held by the depository on the purchaser's behalf, free and clear of all liens and encumbrances, other than liens of the purchaser, tax liens, liens agreed to by the purchaser, or liens of the depository for fees and expenses, which have previously been disclosed to the purchaser. For the purpose of this paragraph, "financial institution" means a bank, savings institution or trust company organized under, or supervised pursuant to, the laws of the United States or of this state.

17. Transactions involving a commodity investment contract solely between persons engaged in producing, processing, using commercially or handling as merchants each commodity subject to the contract or any by-product.

18. A nonissuer transaction in an outstanding security, including the sale by a dealer, including an underwriter no longer acting as an underwriter in respect to the securities involved, of securities sold and distributed to the public, but not including securities constituting an

unsold allotment to or subscription by the dealer as a participant in the distribution of the securities by the issuer or by or through an underwriter if both of the following apply:

(a) The class of security has been outstanding in the hands of the public for not less than ninety days preceding the date of the transaction.

(b) The securities are listed on an automated quotation system of a national securities association registered under the securities exchange act of 1934.[16]

19. Transactions involving the sale of securities to persons who are not residents of this state and are not present in this state if all of the following conditions are met:

(a) The securities being offered are not blind pool offerings.

(b) At least ten days before the offering date:

(i) The issuer certifies that the securities being offered will be offered and sold in compliance with the securities act of 1933[17] and the laws and regulations of those states in which the offers and sales will be made.

(ii) The issuer files as a notice filing one copy of any offering materials which may be required by the securities and exchange commission or the laws and rules of those states in which the offers and sales will be made.

(iii) The issuer submits a filing fee of two hundred dollars.

(c) Within ten working days of completion of the offering the issuer files a description of the actions taken as to compliance with the securities act of 1933 and the laws and rules of those states in which the offers and sales were made.

(d) The transaction complies with any rule adopted by the commission further restricting the exemption created by this paragraph to prevent any fraudulent practices.

20. Transactions involving offers or sales of one or more promissory notes directly secured by a first lien on a single parcel of real estate on which is located a dwelling or other residential or commercial structure and participation interest in those notes that are exempt under § 4(5) of the securities act of 1933.[18]

21. A nonissuer transaction in a security of an issuer that files reports with the securities and exchange commission pursuant to § 13 or 15(d) of the securities exchange act of 1934.

B. The provisions of subsection A, paragraph 11 of this section do not apply to either of the following:

1. Sales by a dealer or salesman who is not registered in this state.

2. Solicited sales to or purchases from a resident of this state by a dealer who does not have, before the initial solicitation, a written new account form signed by the resident or a customer agreement signed by the resident and a previous sale or purchase of a security with the resident.

C. The commission may by order revoke or suspend the exemption under subsection A, paragraph 11 or 18 of this section with respect to any securities or the use of the exemption under subsection A, paragraph 11 of this section by any dealer if it finds that the further sale in this state of the securities or by the dealer would work, or tend to work, a fraud or deceit on the purchaser.

A.R.S. § 44-1891

ARIZONA REVISED STATUTES ANNOTATED
TITLE 44. TRADE AND COMMERCE
CHAPTER 12. SALES OF SECURITIES
ARTICLE 7. REGISTRATION OF SECURITIES BY QUALIFICATION

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§ 44-1891. Registration by qualification

Securities required to be registered by qualification under this chapter before they may be sold in this state shall be registered as provided in this article.

A.R.S. § 44-1902

ARIZONA REVISED STATUTES ANNOTATED
TITLE 44. TRADE AND COMMERCE
CHAPTER 12. SALES OF SECURITIES
ARTICLE 7. REGISTRATION OF SECURITIES BY QUALIFICATION

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§ 44-1902. Power of the commission to register certain securities by uniform limited offering registration

A. In accordance with rules adopted by the commission, the commission may register under this article certain securities in an aggregate amount not exceeding five million dollars in any twelve month period.

B. The rules adopted by the commission pursuant to subsection A of this section shall include:

1. A disclosure document as prescribed by the commission.

2. That the offering is not a blind pool offering.

3. That the issuer is not an investment company subject to the investment company act of 1940.[14]

4. That the issuer is not subject to the reporting requirements of § 13 or § 15(d) of the securities exchange act of 1934.[15]

5. That the issuer of debt offerings can demonstrate ability to service its debt.

6. That the application for a uniform limited offering registration is accompanied by a nonrefundable fee as provided in § 44-1861.

7. That financial statements and other financial information, if any, required for registration shall be prepared in the manner prescribed in the rules adopted by the commission pursuant to subsection A of this section, notwithstanding any other provision of this chapter.

A.R.S. § 44-1972

ARIZONA REVISED STATUTES ANNOTATED
TITLE 44. TRADE AND COMMERCE
CHAPTER 12. SALES OF SECURITIES
ARTICLE 11. HEARINGS

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§ 44-1972. Notice of and opportunity for hearing; time of hearing

A. Before entering an order denying or revoking the registration of any securities as provided in § 44-1901 or article 8 of this chapter[16] the commission shall send to the issuer of the securities, and, if the application for registration of the securities was filed by a registered dealer, to the dealer, a notice of hearing or notice of opportunity for hearing.

B. Before entering an order denying, revoking or suspending except temporarily the registration of a dealer or salesman as provided in article 10 of this chapter,[17] the commission shall send to the dealer or salesman, and, if a salesman, to the registered dealer who employs or intends to employ the salesman, a notice of hearing or notice of opportunity for a hearing.

C. Before entering an order to cease and desist or an order for rescission, restitution or penalties, the commission shall serve on each respondent a notice of a hearing or a notice of an opportunity for a hearing. The commission by rule may provide for temporary cease and desist orders where the public welfare requires immediate action.

D. Notices of hearing or notices of opportunity for a hearing shall be served as prescribed by rules adopted by the commission for service of subpoenas and cease and desist orders. The notice shall contain a statement of the matters to be considered and, if a notice of opportunity for a hearing, shall set forth that the person to whom the notice is sent will be afforded a hearing upon request to the commission if the request is made in writing within ten days after receipt of the notice.

E. When a person requests a hearing in accordance with the provisions of this article, the commission shall set a date, time and place for the hearing and shall forthwith notify the person requesting the hearing. For a hearing held pursuant to subsection A of this section, the date set for the hearing shall be within fifteen days, but not earlier than five days after the request for a hearing has been made, unless otherwise agreed to by both the commission and the person requesting the hearing. For a hearing held pursuant to subsection B of this section, the date set for the hearing shall be within thirty days, but not earlier than fifteen days after the request for a hearing has been made, unless otherwise agreed to by both the commission and the person requesting the hearing. If the hearing is initiated by the commission the notice of hearing shall specify the date, time and place thereof. The date of the hearing shall be within fifteen days of the date of the notice of hearing.

A.R.S. § 44-1991

ARIZONA REVISED STATUTES ANNOTATED
TITLE 44. TRADE AND COMMERCE
CHAPTER 12. SALES OF SECURITIES
ARTICLE 13. FRAUDULENT PRACTICES

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Current through End of the 1998 2nd Regular Session and the 6th Special Session

§ 44-1991. Fraud in purchase or sale of securities

A. It is a fraudulent practice and unlawful for a person, in connection with a transaction or transactions within or from this state involving an offer to sell or buy securities, or a sale or purchase of securities, including securities exempted under § 44-1843 or 44-1843.01 and including transactions exempted under § 44-1844, directly or indirectly to do any of the following:

1. Employ any device, scheme or artifice to defraud.

2. Make any untrue statement of material fact, or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

3. Engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit.

B. In a private action brought pursuant to subsection A, paragraph 2 of this section or § 44-1992, if the person who offered or sold the security proves that any portion or all of the amount recoverable under subsection A, paragraph 2 of this section or § 44-1992 represents an amount other than the depreciation in value of the subject security resulting from the part of the prospectus or oral communication, with respect to the liability of the person is asserted, not being true or omitting to state a material fact required to be stated or necessary to make the statement not misleading, then the amount shall not be recoverable. This subsection does not apply to any actions based on allegations of activities constituting dishonest or unethical practices in the securities industry.

A.R.S. § 44-2032
ARIZONA REVISED STATUTES ANNOTATED
TITLE 44. TRADE AND COMMERCE
CHAPTER 12. SALES OF SECURITIES
ARTICLE 16. ENFORCEMENT

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§ 44-2032. Cease and desist orders; injunctions; civil restitution; prosecutions for violations

When it appears to the commission, either upon complaint or otherwise, that any person has engaged in, is engaging in, or is about to engage in any act, practice or transaction which constitutes a violation of this chapter, or any rule or order of the commission thereunder, the commission may, in its discretion:

1. Issue an order directing such person to cease and desist from engaging in such act, practice or transaction, or doing any act in furtherance thereof, and to take appropriate affirmative action within a reasonable period of time, as prescribed by the commission, to correct the conditions resulting from the act, practice or transaction including, without limitation, a requirement to provide restitution as prescribed by rules of the commission.

2. Apply to the superior court in Maricopa county or any federal court for an injunction restraining such person from any such violation, and upon a showing by the commission that the person has engaged in, is engaging in or is about to engage in an act, practice or transaction in violation of this chapter or any rule or order of the commission, a temporary restraining order, preliminary injunction, or permanent injunction shall be granted

without bond. Process in such actions may be served upon the defendant in any county of this state where he transacts business or is found.

3. Apply to the superior court in Maricopa county or any federal court for an order restoring to any person in interest any monies or property, real or personal, which may have been acquired or transferred in violation of this chapter.

4. Transmit any evidence available concerning such act, practice or transaction to the attorney general whereupon he may petition the superior court in Maricopa county for the appointment of a conservator to reorganize the affairs of, or a receiver to wind up the affairs of, the violator. Process in such actions may be served upon the defendant in any county in this state where the defendant transacts business or where he may be found.

5. Transmit any evidence available concerning such act, practice or transaction to the attorney general who may, with or without such transmittal, in his discretion, directly institute or cause to be instituted such criminal proceedings as the evidence warrants.

A.R.S. § 44-2036

ARIZONA REVISED STATUTES ANNOTATED
TITLE 44. TRADE AND COMMERCE
CHAPTER 12. SALES OF SECURITIES
ARTICLE 16. ENFORCEMENT

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§ 44-2036. Administrative penalty

A. A person who, in an administrative action, is found to have violated any provision of this chapter or any rule or order of the commission may be assessed an administrative penalty by the commission, after a hearing, in an amount of not to exceed five thousand dollars for each violation.

B. Any penalties collected pursuant to this section shall be remitted to the state treasurer for deposit in the state general fund.

C. If judicial review has not been sought under title 12, chapter 7, article 6,[18] a certified copy of any commission order requiring the payment of restitution or administrative penalties may be filed in the office of the clerk of the superior court in any county of this state. The clerk shall treat the commission order in the same manner as a judgment of the superior court. A commission order so filed has the same effect as a judgment of the superior court and may be recorded, enforced or satisfied in like manner. No filing fee is required under this section.

BEFORE THE ARIZONA CORPORATION COMMISSION

RENZ D. JENNINGS
Chairman
MARCIA WEEKS
Commissioner
CARL J. KUNASEK
Commissioner

IN THE MATTER OF: NUTEK INFORMATION SYSTEMS, INC. JEFFREY A. SHUKEN 6390 Greenwich Drive, Suite 110 San Diego, California 92122 AKS DAKS COMMUNICATIONS, INC. SMR ADVISORY GROUP, L.C. ALBERT KOENIGSBERG 3801 N. University Drive, Suite 315 Sunrise, Florida 33351 Respondents.	*	DOCKET NO. S-3046-I

RESPONDENTS AK'S DAKS COMMUNICATIONS, INC., SMR ADVISORY GROUP, L.C., and ALBERT KOENIGSBERG'S PROPOSED FINDINGS OF FACT

I. PROPOSED FINDINGS OF FACT

[The Notice of Opportunity for a Hearing Regarding Proposed Order to Cease and Desist will be noted as PCD, the Amended Notice of Opportunity for a Hearing Regarding Proposed Order to Cease and Desist will be noted as APCD, the Answers as Answer, and thereupon appropriately indicated which answer, Federal Communications Commission as FCC, the Arizona Corporation Commission as ACC, and its Securities Division as the Division. The record will described as Tr. and specific lines on a designated page as, L(s). The State's exhibits will be referenced as S. and the Respondents exhibits as R. Other short hand denotations will be indicated as necessary in the text.]

A. The Respondent Parties.

1. Aks Daks Communications, Inc. ("Aks Daks") is a corporation duly organized under the laws of the State of Florida. (S. 2). Its offices are located at 3801 North University Drive, Sunrise, Florida. (PCD, APCD and Aks Daks Answer, each at ¶ 4. It nor any interests representing its existence or transactions are registered with the Division of the ACC. (S.6).

2. SMR Advisory Group, L.C. ("SMR Advisory") is a limited liability company (LLC), duly organized under the laws of the State of Texas. (S.3, 47, 66, 93, 94). Its offices are located at 3801 North University Drive, Sunrise, Florida. PCD, APCD and SMR Advisory Answer, ¶ 5). It nor any interests representing its existence or transactions are registered with the Division of the ACC. (S.7).

3. Albert ("Albie") Koenigsberg is founder, president and chief executive officer of SMR Advisory. He is not registered with the Division of the ACC. (S.8, 47, 66, 89, 91, 92, 93 & 94; Tr. 1087, Ls. 9 & 10).

4. Nutek Information Systems, Inc. ("Nutek") is a corporation duly organized under the laws of the State of California. (S.1) Its offices are located 6390 Greenwich Drive, Suite 110, San Diego, California 92122. (PCD, APCD and Nutek Answer, ¶ 2). It nor any interests representing its existence or transactions are registered with the Division of the ACC. (S.4). Nutek is a membership recruiter for several LLCs which are subject to this proceeding. (S. 84).

5. Jeffrey Shuken, is an employee of Nutek. He is an administrative clerk. (Tr. 1143, Ls. 23-25 to 1144, Ls. 2-7). His business address is 6390 Greenwich Drive, Suite 110, San Diego, California 92122. (PCD, ¶ 3 and Nutek Answer ¶ 3). He is not registered with the Division of the ACC. (S.5).

B. Improper Proceeding.

This proceeding was brought by the Division before it examined the business' structure or how the members participated in the LLCs. (Tr. 351, Ls. 23-25 through Tr. 352, Ls. 1-2), even though Mr. Oliverio mentioned he knew it was an important factor in determining whether the LLC interests were securities. (Tr. 353, Ls. 3-19). Nor did the Division have any investor concerns or talk to any investors before bringing the PCD. (Tr. 995, Ls. 23 to 39, Ls. 1-6).

C. Description of the LLCs, the business plan and the 220 MHz Industry.

1. Each member/partner was provided a Membership Summary prior to making a decision on whether to go forward with

their investment in the LLC. The Membership Summary contained a full description of the LLCs, the business plan and the 220 MHz industry, along with the relevant contracts for bringing about the relationships of the membership and their business plan, including but not limited to: the LLC's Articles of Organization, Articles of Amendment, the Membership Operating Agreement (Regulations), Administrative Agent Agreement (*hiring Aks Daks to perform booking and other ministerial functions for the forming LLC*), Membership Recruitment Agreement (*hiring outside agents to find the LLC member/partners*), 220-222 MHz System Management Agreement (*the contract that commits a 220-222 MHz license holder to join the LLC and contribute his license to the LLC as his/her/its capital contribution in return for building out the license, see S. 121-127, 130*), Asset Purchase Agreement and Equipment Lease Agreement, (*each being and incidental to the 220-222 MHz System Management Agreement*), a 220-222 MHz System Construction and Management Agreement (*committing SMR Advisory to perform the construction and management duties the LLC committed to do for the license holder in return for an interest in the LLC*), Agreement to Perform Compliance Interviews (*self descriptive*), Marketing and Consulting Agreement (*to find users for the dispatch system*), and LLC financials. Said Membership Summary and its attachments are made part of these findings and incorporated herein by reference, as if it was written herein in full.

(S. 47, 66, 91, 92, 93 & 94; Tr. 133; Tr. 270, Ls. 3-19).

a. A description of the LLCs, their organization and form, the business plan and the 220 MHz industry, more fully described in paragraph I.C.1., *supra,* would include the following (All the following taken from S. 47, 66, 48, 91, 92, 93 and 94, items taken from other area of the evidence are specifically noted.):

   (1) An LLC may be generally defined as an unincorporated association comprised of at least two or more members, which has general partnership characteristics and some corporate, such as liability limited to paid in capital. An LLC may be managed by its members, or it may be managed by (a) manager(s). Each of the LLCs subject to this proceeding is a recently formed, member managed, Texas LLC.

   (2) Each LLC was formed to construct, maintain and operate a 220-222 MHz Business Communications System capable of providing services such as dispatch service, private calling, interconnect calling, no answer forwarding, and "follow me roaming/dispatch networking." A typical system's major working components are (normally) one repeater per channel, one controller per repeater, combiners, antennas, towers, huts and

a mobile or base station, and an interconnect call router. The 220-222 MHz service is basically a two-way dispatch service, but may have interconnect abilities. This type of facility is generally utilized by ambulance services, delivery and transportation services, real estate agents, and other related industries. (*Each of the technical terms used in this paragraph has a definition which may be found in either the Glossary or footnotes 2-13 of the Membership Summaries, S. 47, 66, 91, 92, 93 and 94, see also testimony of Jian Golestani, pages 609 through 615 and 643, Ls. 13-25.*).

(3) SMR Advisory and one other member, who came from either the public or an affiliate (such as a 220-222 MHz licensee) was an originating Class A member of each of the LLCs. Class B members included the solicited public members/partners and to a lesser extent (no more than 28% of the outstanding ownership of the LLC) the original Class B members/partners. As a Class A member, SMR Advisory, committed the LLC to certain performance duties pursuant to an industry standard construction and management agreement for 220-222 MHz Business Communication Systems, *i.e.* the construction and

thereafter management of a particular 220-222 MHz system for a particular license holder. (*See a description of the various "initial" agreements that were provided by the original Class A members to the Class B members, at paragraph I.C.1.*). SMR Advisorys consideration for performing these duties for the LLCs is an eight percent (8%) equity ownership interest of the LLC's Class B interests. Upon completion of the operating 220-222 MHz system, the Class A membership ceases to exist and the Class B members hold all control. During the Class A period of the LLCs' existence, the LLC is committed to perform pursuant to the advice and consent of the existing prospective (Class B) member/partners. Also, during the construction of the first forty (40) licenses, SMR Advisory received no remuneration for its efforts. It seeks only future profits from its eight percent (8%) interest, but can also get, as system manger, eighty dollars ($80.) per month per channel managed or twenty five percent (25%) of gross usage receipts if the systems become "loaded" with subscribers paying usage fees. At the time of the this proceeding, SNM Advisory had delivered some thirty four (34) to forty (40) fully functioning dispatch systems. (S.52; Tr. 255, Ls. 10-11; Tr. 258, Ls. 8-14; Tr. 336, Ls. 20-25; Tr. 535, Ls. 9-15). At the time of this proceeding SMR Advisory still awaited delivery of its eight percent (8%) due it by contract from each of those LLCs. SMR Advisory was thereupon operating at a loss to finance the partnership undertakings. SMR Advisory was going to oversee the 220-222 MHz System operations on behalf and under the auspices of the various LLCs. (Tr. 286, Ls. 22-25; Tr. 465, Ls. 19-25 to 466, L. 1). Unless the member/partners chose to remove them for less than adequate performance. (Tr. 319, Ls. 20-25 to 320, Ls. 1-20).

(4) In its capacity as administrative agent to the LLCs, Aks Daks is currently entitled to receive a fee of twelve percent (12%) of all membership reservation fees paid to the LLC. Such fees, which are a one time payment, are utilized by Aks Daks to maintain offices for the LLC and to pay for various administrative activities and expenses, including, but not limited to the preparation and mailing of LLC communications, conference calls, hiring of administrative and clerical staff and maintenance of the LLC's books and records. (Tr. 286, Ls. 17-21; Tr. 1156, Ls. 15-25 to 1157, Ls. 1-6).

(5) During the construction phase the Class B members were asked to make the major decisions to build out the system and suggested changes to the business plan or membership regulations. Some were accepted by the overall membership, others were rejected. Each LLC received various proxies, but each received in excess of a dozen proposals to vote upon. Some had to make special decisions on unique equipment requirements given peculiarities of the location of their dispatch system. (*See additionally*, S. 37, 38, 46, 55, 62, and 64).

(6) Each Class B member, during the construction period had the right to request the full refund of his/her/its reservation monies, for any reason. (S. 34 & 37 &; Tr. 129-130). Once construction was completed each member was given an LLC tailored Membership Summary, which became known to the member/partners in the vernacular, as the "Brick." It provided information about, *inter alia,* the risks incidental to the project, a description of the intended business plan (which, of course, was dependant upon approval and changes by the Class B members upon taking over total company operation), and a description of the 220-222 MHz industry. Upon receipt of the Brick,

the potential members had seven days to decide whether to proceed with their membership/partnership or ask for return of their reservation payment. Of the Business Communication Systems delivered at the time of the hearing in this matter, every member which sought a refund had received a full refund within approximately one week of his/her/its making such a request. (S. 34, 47, 66, 91, 92, 93 and 94). At the time of the hearing, in excess of three hundred fifty thousand dollars [$350,000] of requests have been made and paid out to prospective members.

See MTA-EMCI "Fair Market Valuation of Western Regional Network, Prepared for SMR Advisory Group, February 6, 1995, by MTA-EMCI, Washington, D.C. (R. 6), for further information about the industry, and the value of the systems delivered to the Class B members/partners. *See S.47, page 25, and Tr. 155, Ls. 8-16, for confirmation of delivery of equipment to SMR Advisory to build the systems.*

2. Notwithstanding the incorporation by reference of the Membership Summary in paragraph I.C.1., *supra,* it is worthy to list the many risk warning discussions provided each prospective member (each risk containing one or more paragraphs explaining the exposure). The topics printed and written about in a very candid manner in each membership package includes:

a. Absence of Operating History; Losses; Anticipated Negative Cash Flow; No Assurances of Profitability or of Distributions,

b. Allocation of Profits and Losses; Taxation of the Company,

c. New Industry; Uncertainty of Market Acceptance,

d. Limited Interpretive Law Concerning LLCs Generally,

e. Challenges by Securities Regulators; Current Litigation Concerning Whether LLC Membership Interests Constitute Securities, (*see also R. 1, footnote and Tr. 138-139*),

f. Potential Refunds of Reservation Fees,

g. Potential Loss of Capital Contribution; Potential Need by Company for Additional Capital,

h. FCC Regulations Generally; Ownership Restrictions; Loss of License,

i. Requirement for Licensee to Maintain Substantial Control of License,

j. No Assurance that the System will be Completed and in Operation by the FCC Deadline; Potential Loss of Entire Capital Contribution,

k. Competition,

l. Potential Conflicts of Interest,

m. No Audit Financial Statements,

n. Absence of Public Market; Illiquidity of Membership Interests,

o. Potential Issuance of Additional Membership Interests; Dilution,

p. Arbitrary Determination of Offering Price of Individual Membership Interests and Terms and Conditions Relating Thereto, and

q. No Assurances of Formation of Western Regional Network ("WRN") or of Company Joining Any Such Network.

The risks were prominent and the typical investor in the LLCs subject to this proceeding understood them and decided that they were acceptable in light of the potential outcome of the membership/partnership efforts and expectations. (Tr. 290-292 and 294-295).

3. Thus, the Membership Summary, among other things, amounted to a competent disclosure of the risks incidental to entering into the membership/partnership. One might ask, " . . . what more can they do to warn Mr. Six-Pack" (Tr. 833 to 835, Ls. 1-3; particularly, 835, Ls. 2-3).

4. During the proceeding no less than four (4) substantially alike Membership Summaries were introduced into evidence, each representing four (4) different arrangements of its members with the incidental contracts. S. 91 Membership Summary was used by Bakersfield 220 Holdings, II, L.C., Bakersfield 220 Holdings, V., L.C., Bakersfield 220 Holdings, VI, L.C., California 220 Holdings, VI, L.C., Fresno 220 Holdings, IV, L.C.,

Fresno 220 Holdings, Fresno 220 Holdings, VI, L.C. Oregon 220 Holdings, I, L.C., and Sacramento 220 Holdings, I, L.C. S. 92 Membership Summary was used by California 220 Holdings, VII, L.C. California 220 Holdings, VIII, L.C., Oregon 220 Holdings, III, L.C., Oregon 220 Holdings, V., L.C. and Washington 220 Holdings, I, L.C. S. 93 Membership Summary was used by Sattley 220 Holdings, I, L.C. and S. 94 by Fresno 220 Holdings VIII, L.C. Those fifteen (15) LLCs are the only LLCs (out of the forty [40] delivered at the time of this hearing) that have Arizona residents as members. The difference between the Membership Summaries for purposes of this proceeding, are not material.

5. Various Arizona residents did apply for prospective membership in the several LLCs subject to this proceeding. (S. 85 & 86). Most of those who were prospective members became actual members, that is Class B members.

6. Members of the various LLCs were provided membership lists of the other members in their particular LLC. (S. 73-74; Tr. 268, Ls. 21-25 to Tr. 269, Ls. 1-8; Tr. 355, Ls. 18-22; Tr. 494, Ls. 9-22; Tr. 546, Ls. 1-23). Members voted on issues from at least once or twice per month. (Tr. 354, Tr. 513, Ls. 3-8).

D. Federal Communications Commission Regulation of the Relevant Market Place.

1. The member/partners, in entering into their commitments were informed, verbally and in written form that FCC rules and regulations required the licensee to have ultimate

control over the license's utilization. Jr. 134, Ls, 5-22; Tr. 147 & 148, Ls. 1-3).

E. Western Regional Network

1. In the summer of 1994 twenty-two (22) of the then existing LLCs voted to commence discussions amongst such LLCs to enter into a cooperative operating relationship and to give owners of compatible systems the opportunity to join and potentially enhance their business opportunity. Such proposed cooperative relationship was generally referred to as the Western Regional Network or "WRN." No assurances were given that the proposed WRN would ever be established, or for that matter, that the Company will become a member of the proposed WRN. It was generally contemplated that if such cooperative arrangement eventually became consummated, it would consist of a conglomeration of one or more such LLCs and/or other business enterprises, each of which would either (i) hold directly at least one five (5) channel 220-222 MHz license, or (ii) had entered into a construction and management agreement with the holder of such a license. It was anticipated that the LLCs that expressed an interest in forming a WRN and any other business enterprises that may join in the future will be compatible with, and complement or add to, a virtually seamless network from Northwest Washington State south along the United States Pacific Coast and east through Nevada and perhaps

beyond.[1] The LLCs that had expressed an interest in a WRN, at the time of the hearing, had an aggregate of approximately one hundred seventy (170) to two hundred (200) presently completed[2] "on the air" channels. Additionally, each LLC had in common Aks; Daks as its administrative agent and SMR Advisory as a member and has contracted with SMR Advisory to negotiate the LLCs construction and management agreement with the license holder and operate same on behalf of the LLC. (S.47, 66, 91, 92,

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[1] If such a WRN was formed with similarly situated LLCs and other business entities or persons, coverage may include the following: Spokane and west from the eastern Seattle area through Olympia, then south on Highway 5 to Portland and continuing on to Salem, Eugene and Grants Pass (ten more channels in Washington remain to be completed). In California, to Redding, Chico, Marysville and Yuba City (with an arm running to Grass Valley, and northeast through Truckee and following Highway 80 to Reno and Carson City areas) with the main direction continuing down Highway 99 south through Sacramento, Stockton, Modesto, Merced and Fresno. Still on Highway 99, to Visalia, Bakersfield and to Grapevine, merging with Highway 5. From Bakersfield, east on Highway 58 towards Tehachappi, Mojave, Barstow and Las Vegas (possible small gaps may exist on this lap because of adverse topography.) From Coalinga (San Joaquin Ridge site), linking Highway 41 and 46 to Tassajara Peak at San Luis Obispo. Thereupon at Highway 101, from Bradley through San Luis Obispo to Santa Maria joining Santa Ynez Peak and then down to Santa Barbara and to the Los Angeles city limits (where corresponding relationships are being established with in town systems), and eastward from there to approximately Las Vegas, Nevada. (S. 47, 66, 91, 92, 93, 94; R. 16 & 22).

[2] If all similarly situated LLCs join a WRN, such a network would contain approximately two hundred (200) channels.

93 & 94: Tr. 152; Tr. 265, Ls. 23-25 to 266, Ls. 1-10).

2. A "network" is two or more sites capable of communicating. (Tr. 258, Ls. 20-21; Tr. 611, Ls. 21-25).

3. SMR or special mobilized radio is a series of five-channel transmitters that will trunk from one channel to the next if one channel happens to be busy. These FCC licenses have the capability to make telephone calls by interconnection to the land lines. (Tr. 610, Ls. 15-21).

4. The State alleged that the business entity being sold was an interest in the WRN, that the Respondents did this through the forty (40) LLCs. (APCD, ¶¶ 8, 9, 10). The PCD alleged the individual LLCs were securities. The APCD does not reference LLCs as securities as the original PCD did, but alleges the WRN, itself a non-existent entity to be a security. For purposes of this proceeding, the WRN at most, would be a joint venture, *i.e.* a partnership, among the several LLCs. The comments of all the members was contrary to the assertions of the Division. (Tr. 582, Ls. 22-25 through 583, Ls. 1-12:Tr. 1095, Ls. 12-25, through 1099, Ls. 1-14; *See also paragraph, I.I.12., infra.*). For example, W. Donald Pershing, (*see infra at I.G.7.*, and sequential paragraphs), was asked whether he thought the potential customer base would come from a network as opposed to a single site and stated, that:

> A. Yes. I have to honestly say I was hoping that (Tr. 265)

one day this would all be merged into one network and one company, but I understood that it was going to be tied to one site.
Q. What was the source of your hopes for this being tied to a network?
A. To me, it looks like a more viable and more valuable company. If they're all merged into one company, you have – the sum total is greater than the individual parts. And that was my – you know, that's just the kind of basic economic principle sometimes. (TR. 266).

Further, he was not told that by either of his membership recruiters that his investment was in a network, but actually told his investment was in an individual site. (Tr. 266, Ls. 11-13, through to 267, Ls. 1-8).

5. The State contended often at the hearing that the potential members were not given an opportunity to choose from which of the forty (40) potential sites and corresponding LLCs in which they would participate. Yet, each investor indicated that he knew that the offer to participate was in the then prevailing or under construction site, and were not concerned with fact. (TR. [sic] 120, Ls. 19-25; Tr. 264, Ls. 17-25; Tr. 264-265; Tr. 568 to 570, Ls. 1-4).

6. The State also attempted to assert that there was something wrong with the fact that

LLC activities had begun prior to certain members joining the LLC, and that later entering members had to affirm the prior acts of the LLC. Such seems to be the common, if not natural and proper way for new members to join any partnership or LLC. In any case, it was candidly revealed by the Respondents and assented to by the accepting member/partners. (R. 2 & 3; Tr. 276, Ls. 22-23 to 277, Ls. 1-7). Other members/partners who didn't want to affirm the prior acts simply did not subscribe to become a member and received a full refund. (S.48 & 34; Tr. 96, Ls. 21-25, 97, Ls. 1-5; Tr. 126 127). The program itself provided for a refund to any prospective member at any time, from the time the prospective member placed his funds with the LLC until seven days after a prospective member received his Membership Summary and elected to go forward or not go forward with participation in the partnership/membership. (S. 47 & 48, 91, 92, 93 & 94; Tr. 97, Ls. 20; Tr. 301, Ls. 12-25).

7. The State also attempted to raise the issue of whether the commitment began at the time the prospective members provided their funds and became prospective members or when the prospective member exercised his option to become a member, after being provided with the Membership Summary. If the APCD is read to assert that the sale of interests in the individual LLCs[3]

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[3] One cannot be sure whether the APCD is charging that sale of the LLCs or just the WRN is the offering of a security. For purposes of this matter we will presume it alleges each

constituted securities transactions, and we were to conclude that the enterprise began for each member/partner at the time his/her/it's membership subscription is accepted, we would characterize the prospective membership period as each member/partner being a general partner with the LLC (as being operated by the Class A members) which then became an LLC consisting of the prospective members and the Class A members, *i.e., an LLC of the Class B member/partners.*

F. The Division's Undercover Investigator's Communications.

1. Kenneth William Oliverio, a/k/a Billy Oliverio is a senior investigator with the ACC and has held the position since August of 1993. (Tr. 52, lines Ls. 1-9; Tr. 226, Ls. 1-5). His duties include, conducting investigations regarding violations of the Arizona Securities Act, gathering evidence and maintaining case files. (Tr. 226, Ls. 8-11). His duties with the Commission on the topic of securities began as soon as he came to work for the Commission. It admittedly took him a "little while to adjust to securities.." (Tr. 227). Mr. Oliverio stated that the present case concerned SMR licenses and that such is a distinct product from wireless cable. (Tr. 230, Ls. 1-13).

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individually would amount to the sale or offer of a security. The testimony is absolute that the WRN did not come into being during the time period examined at the hearing and was but an idea being considered by the several LLCs and therefore could not sold or offered.

2. In the summer of 1994, Mr. Oliverio heard of Nutek from a Mr. Craig Wright, a contact from a prior investigative responsibility. Mr. Oliverio was not seeking sales information, but merely returning Mr. Wright's call. (Tr. 231, Ls. 10-25). He never spoke with Mr. Wright on the subject of this proceeding. (Tr. 53, Ls. 8-25 and Tr. 55, L. 1). Instead he spoke with Mr. Shuken. He tape recorded the Oliverio-Shuken conversations. (S. 75 & 76; Tr. 54, Ls. 1-9). It seems from the record that Mr. Shuken was not a salesperson, but rather a member of one of the LLCs and coincidentally an employee of Nutek. (Tr. 232, Ls. 1-7; Tr. 244, Ls. 23-25 & 245, Ls. 1-11.) Mr. Shuken was a Member/partner in some of the LLCs himself. (Tr. 447, Ls. 4-13).

3. When Mr. Oliverio was asked at the hearing whether, during his second conversation, he was "misled," he was unable to respond, but implied that he had no adverse information to report. (S. 75, 76, 78 & 79; Tr. 234, Ls. 15-23; Tr. 235-238, Ls. 1-10). Mr. Oliverio also agreed on cross examination that, on November 11, 1994, when talking about exit strategies from the investment, Mr. Shuken was careful to explain such under the condition, that exit strategies were possible, "if all goes well." It was also obvious from the testimony that Mr. Shuken never indicated to Mr. Oliverio that the initial mailing contained all the information necessary to go forward with the investment. In fact, when Mr. Oliverio asked whether he had all of the information he needed, Mr. Shuken's non responsive utterances appear to have been made while Mr. Shuken had Mr. Oliverio on

hold and was speaking to someone else at his offices. (S.75 & 76; Tr. 241, Ls. 7-25 & 242, Ls. 1-17).

4. Mr. Oliverio admitted on cross examination that during his first conversation, "he [Mr. Shuken] was simply telling me what he was doing." In explaining the product, Mr. Shuken also warned that although they were talking about an exit strategy, it could not be guaranteed or promised, by any means. (Tr. 239, Ls., 11-15; Tr. 240, Ls. 7-14). Mr. Oliverio, also admitted on cross examination, that Mr. Shuken told him that there was risk (albeit very little), in that he had also invested in an LLC. Further, he was never told that he was investing in a stock or a bond. (Tr. 243, Ls. 18-25 & 243, Ls. 1-23).

5. Mr. Shuken never asked Mr. Oliverio for money to invest. Any mention of sending money was made by Mr. Oliverio himself In fact, when Mr. Oliverio brought up the subject of where to send the monies Mr. Shuken was unable to tell him the necessary information. (Tr. 244, Ls. 23-25 & 245, Ls. 1-11.)

6. Additionally, as a result of the November, 11, 1994, telephone call to Mr. Shuken, Mr. Oliverio understood that the WRN was not yet in existence. He was told that before it could come about votes had to be taken to approve its formation. (Tr. 246; Tr. 443; Tr. 444 through 446).

7. Mr. Shuken also explained that the company (the LLC) would operate through proxies and in person votes, and Mr. Oliverio's participation as an investor

would be to at least vote. (Tr. 243, Ls. 23-25 & 244, Ls. 1-22). In fact, he spoke of this subject seven (7) times. (Tr. 384 through 389). Mr. Koenigsberg told him many times that as an LLC member he must work together with his co-members. (Tr. 355, Ls. 23-25 to 356, Ls. 1-12).

8. On December 27, 1994, Mr. Oliverio called the offices of Aks Daks to obtain the telephone number of Compliance Interviews of America, the firm performing compliance interviews for the LLCs and unexpectedly Mr. Koenigsberg and a discussion on the investment ensued. (S. 80; Tr. 331-332). During this conversation, Mr. Koenigsberg never discusses participation in the WRN. The discussion only involved an investment in an LLC. (S. 80; Tr. 337). Eight times during his conversation Mr. Koenigsberg told Mr. Oliverio that if he became a member of an LLC, he should expect to be an active participant. *See findings number I.F.17.*

9. In fact, when Mr. Oliverio, in his under cover capacity asked about whether there were any risks to the program, interestingly, the first thing Mr. Koenigsberg warns Mr. Oliverio of is this proceeding and that the risk existed that the State may claim the transaction to be a security. (S. 80; Tr. 351, Ls. 1-22).

10. Mr. Koenigsberg also told Mr. Oliverio, during the December 27, 1994 call, that the LLC members were meeting in Sacramento, California in January, and that if he was considering investing, perhaps he should wait until the meeting, attend the meeting and

make sure it was the type of investment he desired. (S. 80; Tr. 349, Ls. 19-25 to 350, Ls. 1-15).

11. Mr. Koenigsberg also informs Oliverio, that his initial participation will only give him a reservation, not an outright membership in the LLC. (S. 80: Tr. 358, Ls. 19-25 to 359, Ls. 1-3). On the subject of reservation and why it is important to employ the services of Compliance interview of America, Mr. Koenigsberg and Mr. Oliverio exchange the following dialogue in S. 80:, at page 17, starting on line 4; [Brackets added to aid in name recognition]

16 [Koenigsberg] "It is. But
17 unfortunately, Mr. Powers, [Mr. Oliverio's undercover name] because we go to outside sources,
18 okay, membership recruiting organizations to raise the
19 capital, we want to protect you and ourselves because, you
20 know, let's just give a question like this: Do you realize
21 that the 220 megahertz, you know, in this industry, that you
22 can lose all the money that you put up? Do you think a
23 salesman is going to tell you that?"
24 [Oliverio] I respond, "I wasn't told that, so I guess not."
25 Koenigsberg responds, "Well, let's look at it this (S.80; Tr. 360)
1 way: Let's say that we build the infrastructure as we have,

> and it's beautiful, okay? And we never get a subscriber on the system. Well, number one, the FCC rules have to have two subscribers per each five channels, so if we don't have the first two, we could lose the channel or channels, okay?
>
> "So there is all the underlying stuff which, you know, the membership recruiters don't necessarily come out and say. And I think it is in your interest as well as ours. That's there just to make sure that everything that is, you know, supposed to be said is cleared up and said.
>
> "And also, once again, until you get what is firmly known as the brick, which is a 450-page book, approximately, which includes a complete business plan and all the disclosures, all you have is a reservation."
>
> (S.80, Tr. 361)

12. Finally, Mr. Oliverio admits under cross examination, that he was told about the risk of building out the system, FCC compliance risks, the risk of trusting salespersons, and as he had not yet invested, he still didn't get to the plethora of risks that would be provided by the Brick. and the compliance interview. He agrees that all this, "Bespeaks Caution." (Tr. 361, Ls. 20-25 to 362, Ls. 1-15).

13. Neither Mr. Koenigsberg nor Mr. Shuken ever solicited Mr. Oliverio to purchase an interest, but only discussed same with him. In fact, Mr. Koenigsberg encouraged him not to go forward until travelling to Sacramento, California and becoming more informed. (S. 80; Tr. 363, Ls. 10-25 to 364, L. 1).

14. On December 28, 1994, Mr. Oliverio called William Brownell of Compliance Interviews of America, an independent company. (S. 82 & 83; Tr. 398, Ls. 11-16). His purpose was to find out what the LLC compliance interview was about. (Tr. 311, Ls. 20-21). He determined that Mr. Brownell's job was twofold, to make sure each potential member/partner was suitable to participate in the LLC and that membership recruiters were communicating what they were instructed to communicate about the investments. (Tr. 312, Ls. 3-7). The day before in his interview with Mr. Koenigsberg, he was also told that the purpose of the outside compliance company was the same two criteria. (It was also mentioned that an independent company was an unusual method to determine suitability and verify that no misrepresentations were made.) (Tr. 356, Ls. 14-25 to 357, Ls. 1-20). These though, were not the only checks to insure proper solicitation. There was the Brick and a written compliance questionnaire document. (Tr. 358, Ls. 1-14).

15. Mr. Brownell spoke with Mr. Oliverio and told him of the investment even though Mr. Brownell was not hired to do so. On cross,

Mr. Oliverio admitted that there is nothing wrong with the fact that the LLCs hired Compliance Interviews of America., to make sure the membership recruiters properly solicited partners. (S. 82; Tr. 358 through 370, Ls. 1-7). Mr. Brownell informed Mr. Oliverio that if he intends to participate as a member in the LLC he should be an active participant. (S. 82; Tr. 370, Ls. 10-25 to 371, Ls. 1-3). Concerning Mr. Brownell's communication, Mr. Oliverio states, "He explains it quite clearly that members are in control. I don't know what more he could say or can't say. He explains it to me." (S. 82; Tr. 373, Ln. 3-5). Also, Mr. Oliverio agrees that like Messrs. Shuken and Koenigsberg before him, Mr. Brownell speaks of forty (40) distinct and separate LLCs. Further that Mr. Brownell cautions that this venture has many things that could go wrong if the members do not work at it. (Tr. 376, Ls. 1-19; Tr. 378, Ls. 20-25 to 379, Ls. 1-4).). Mr. Oliverio agrees that Mr. Brownell's explanations "bespeak cautions." (S. 82; Tr. 373, Ls. 24-24 to 374, L. 1).

16. Mr. Oliverio solicits from Mr. Brownell the following:

> "If I find any deviation from what they're saying and doing, the people are generally out the door, or the company just shuts the ISO [*i.e.* membership recruiter] down for misleading information,

and out of all the groups I've represented or been retained by, this" – AKS DAKS and the LLCs and SMR or Mr. Koenigsberg and Mr. Shuken in Nutek – "this is one of the most upstanding of groups"
(S. 82; Tr. 377).

17. Mr. Brownell has rejected about twelve persons form being an LLC member, about eight for unsuitability reasons. (S. 82; Tr. 373).

18. During the four (4) taped interviews recorded by Mr. Oliverio of Messrs, Shuken, Koenigsberg and Brownell, told him sixteen [seventeen] (16[17]) times that the investment they were talking about would need his active participation to be successful. Mr. Oliverio did assert that if he was told about the need to be an active participant, three (3) times would be a lot. He was not asked what sixteen (16) times amounted to but did admit that he was not surprised at the number of times he was told he needed to be an active participant in the LLC program subject to this proceeding. All told, Messrs. Shuken, Koenigsberg and Brownell told Mr. Oliverio sixteen (seventeen) (16[17]) times that he must be an active participant in the LLC program. (S. 76, 79, 80 & 82; Tr. 379, *see for recount to seventeen,* Tr. 382 to 383).

19. During his follow up investigation of Arizona residents who participated in the LLCs subject to this proceeding, *to wit.,* Kristine Sundine, Todd Lockwood and Michael Lidke, all advised Mr. Oliverio that they

were satisfied with their investments. Mr. Lidke testified that he was satisfied because of the information he got back and communication and feedback. (Tr. 307 & 310).

G. Customer Witnesses.

1. **Jesse Simmons** Mr. Jesse Simmons, the State's customer witness, is a sixty three year old, retired electrical equipment manufacturer's representative. He holds a doctorate of philosophy and is a reverend minister. Previously, he has been a registered representative and as such held licenses with the New York Stock Exchange, National Association of Securities Dealers and the Securities and Exchange Commission. (Tr. 71, Ls. 1-10; Tr. 124, Ls. 20-23). His own investments have been in stocks, bonds, commodities, mutual funds, and limited partnerships, etc. Prior to his investments that are the subject of this proceeding he had never invested in a general partnership nor an LLC. (Tr. 71, Ls. 20-25 and Tr. 72, Ls. 10).

2. Mr. Simmons first became aware of Aks Daks through the conversations of "some people" whose particular names he did not remember. But he learned of the investment more specifically through conversations with a Mr. Carlos Harden of Gene Manning & Company, and Mr. Koenigsberg. (Tr. 72, Ls. 10-25; Tr. 75, Ls. 17-18). He understood Mr. Harden to be a salesperson, soliciting participants for an LLC in the specialized mobile radio business, and particularly the 220 Megahertz ("MHz") range. (Tr. 73).

3. Sometime in August of 1994, Mr. Simmons invested in the 220 MHz radio communications systems being discussed by Mr. Harden. (Tr. 75, Ls. 5-13) In particular, he was offered a participation in the Oregon 220 Holdings III, L.C., which he understood to be the then available LLC. (S.20, 33 & 34; Tr. 84, Ls. 1-5; Tr. 120, Ls. 17-25). Prior to making any investment in the LLC Messrs. Simmons and Harden had about six (6) conversations considering the investment (Tr. 73, Ls. 5-12). Mr. Simmons was sure that he and Mr. Harden discussed the investment at length during their pre-investment conversations, and that Mr. Harden answered all his questions about the investment (Tr. 77, Ls., 13-15; Tr. 128), but didn't remember many specifics, because, as Mr. Simmons explained, it was a while ago and once he no longer participated in the investment, it was out of his mind. (Tr. 77, Ls. 6-15; Tr. 77, Ls. 5-17; Tr. 80, Ls. 3-5; Tr. 81, Ls. 21-25 and Tr. 82, Ls. 1-23; Tr. 91, Ls. 17-25; Tr. 92, Ls. 4-14; Tr. 112-114). He did remember, at least generally that they did discuss Aks Daks, SMR Advisory and their responsibilities to the overall business plan, (Tr. 77, Ls. 10-15; Tr. 78, Ls. 517), that the members of an LLC had to be active in its management (Tr. 80, Ls., 18-22), and that eventually the various LLCs subject to this proceeding could network their facilities (Tr. 83. Ls. 12-17). After making his reservation, he and Mr. Koenigsberg had a few conversations about the business. During those conversations Mr. Koenigsberg encouraged Mr. Simmons to take an active part in the management of

his LLC and its relationships with the other LLCs. In fact, Mr. Simmons did actively participate in his membership and likewise became a member of the Advertising Committee. (S.49; Tr. 136-137; Tr. 145, Ls. 16-23; Tr. 147 & 148, Ls. 1-3).

4. In his Membership Subscription Agreement, as with all prospective members, Mr. Simmons, was provided the general outline of his commitment as a member to be. It included, but was not limited to, the following:

    1. Subscription.

    Subject to the terms and conditions hereinafter set forth in this Subscription Agreement and in the Membership Summary, the undersigned hereby offers to subscribe to become a Member in the Company, for the number of Membership Interests (sometimes referred to as "Units") which were previously reserved by me (the "Membership Interests"). I understand that upon acceptance by the Company of my Offer to become a Member, the reservation fee previously paid by me for such reservation will be deemed my capital contribution to the Company and will be deemed the full consideration required to be paid by me for the Membership Interests.

    2. Condition to Offer.

    The Offer is made subject to the following restrictions: (a) that you shall have the right to accept or reject this Offer, in

> whole or in part, for any reason whatsoever, notwithstanding prior tender of payment, (b) that the Company is not obligated to accept any Offers to subscribe in the order received or otherwise, and (c) that the undersigned agrees to comply with the terms of this Subscription Agreement and the Membership Summary and exhibits thereto and to execute and deliver any and all further documents necessary to become a Member of the Company.

It thereupon warned the prospective member of some thirteen important considerations or risks to be concerned with before going forward with their subscription, such as reading the Membership Summary, the risk factors contained therein and the Subscription Agreement, and further warned that the prospective investor should be cautious that he/she/it has the ability to provide for their own financial means even if the investment resulted in a complete financial loss. For the balance of the risks, the Membership Subscription Agreement is made part of these findings and incorporated herein by reference, as if it was written herein in full. (S.48).

5. The investment was also never presented to Mr. Simmons as being a security. Its presentation was to the contrary, and this he understood from the time he provided his reservation fees in August, 1994. (Tr. 121, Ls. 6-15).

6. During his pendency as a prospective member, his proxy was sought and/or the casting of his vote on business decisions of the LLC. (S. 37, 38, 41; Tr. 90-91 & 95). In addition, the members of the various LLCs subject to this proceeding organized Management Committees to support the various groups of people (members of the various LLCs), in a mutual endeavor to obtain the benefits of their combined goals. Also, his participation as a member of one of the committees was sought and information was obtained from Mr. Simmons about his qualifications for the other members to consider. (S. 40, 1st paragraph, and thereafter the entire packages contents).

7. Upon receipt of his Membership Subscription Agreement, (sometime after January 5, 1995), Mr. Simmons decided to request the refund of his reservation fees. His full investment was refunded, including any fees that might have been assessed had he gone forward with his participation as a member/partner. (S.48 & 34; Tr. 96, Ls. 21-25, 97, Ls. 1-5; Tr. 126-127).

8. **Donald Pershing.** Mr. Pershing, a State's witness, was first a member/partner in Bakersfield 220 Holdings, V, L.C. and then, at a later date he also became a member of Oregon 220 Holdings I, L.C. Mr. Pershing owns his own business and makes instruments to measure solar radiation. He holds a degree in physics from Arizona State University. (S. 53, 66 & 91; Tr. 174, Ls. 23-25; Tr. 248; Tr. 275, Ls. 8-16). He characterized himself as a man who is always looking for opportunities and

as such has invested in stocks, bonds, mutual funds, oil leasing; wireless TV, real estate and the LLCs subject to this proceeding.

9. He was introduced to the program by a woman named Barbara, who outlined the program, explained it to be a part of the information highway, and it all seemed viable to him. (Tr. 250). Concerning the various cell sites that Mr. Pershing has seen on a map of the western region of the United States, Barbara did describe the map to him but never described to him that any particular relationship existed between the sites (*i.e.* a WRN), but in his reading he came to understand that the sites were supposed to be able to communicate with one another. (Tr. 255-28, Ls. 1-7). His subscription materials were for a single LLC, quite similar to those provided Mr. Simmons' at paragraph I.G.4., *supra.* (S.67; R. 2 & 3; Tr. 276).

10. It was noted that in some of Mr. Pershing's proxy statements where he was given the opportunity to vote on many of the issues confronting the operation of his LLC he chose not to cast a vote. When asked about this fact by the State, he responded:

Q. " . . . Did you deliberately execute the document without casting a vote for or against?

A. I think I did, and I have done this with other things, and if I'm not completely informed on the details, I – I won't make a decision one way or the other. I assume

> that – that the people that I'm dealing with are working for the best interest of it.
>
> If I make a decision that's against something uninformed or for something uninformed, that – you know, that's two votes in the wrong direction. And so I do – I've done this before. So they know that I'm aware that I've looked at it, and I just leave it to the person who has the proxy to make the best decision.

(Tr. 260; *see likewise* Tr. 267, Ls. 11-25; Tr. 268).

11. Mr. Pershing admitted that at the time of making his investment he was told that he would need to be an active participant, including participating in proxies, . . . "but it didn't sink in, the amount of proxies and decisions that I would have to be making on this . . . " He had thought he would be like a limited partner, although he was never told that. Rather, he was told the contrary. (Tr. 260, Ls. 22-25 & 261, Ls. 1-10; Tr. 267, Ls. 20-25 through 268, Ls. 1-6; Tr. 277, Ls. 8-13). Yet, after he realized that his ownership rights were significant, he still decided to continue with his membership/partnership. (Tr. 277, Ls. 19-25 to 278, 1-6; Tr. 289; Tr. 292, Ls. 220-25 to 293, Ls. 1-8).

12. **Mark A. Lidke.** Mr. Lidke, the Respondent's witness, is a reliability engineer at

Motorola, Products Sector. He does accelerated life testing on computer chips. Previous to his position at Motorola, he worked in the nuclear waste industry and international petro chemical design. He holds both a bachelor and a master's degree in chemical engineering from California Poly, Ponoma. He also holds a master's in electrical engineering from the University of Arizona. He is very familiar with the SMR industry, partly through personal knowledge and otherwise from his position at Motorola. (R. 5; Tr. 461 through 462). Mr. Lidke is a member of Fresno 220 Holdings, I, V, and VI, Bakersfield IV and VI and Oregon III. (R.6; Tr. 463). From the beginning, he understood his participation was encouraged. (Tr. 502, Ls. 10-25 to 503, Ls. 1-13).

13. Based on his investment experience in his LLCs he understands that each LLC is separate and distinct from each other. Thus, he is not a member of the WRN because it did not exist at the time of the hearing. (Tr. 463; Tr. 486). Mr. Lidke defined the WRN as, "[i]t's the vision of the individual LLCs that, at some point in time, that we will join together in a regional network. At least that is our goal; and we are taking steps, preliminary steps, to obtain that goal." (S. 8, last page, "Formation of the Western Regional Network"; Tr. 463 to 464, Ls. 1-5). Mr. Lidke joined several different LLCs to provide his influence in getting the LLCs to form the WRN. He feels that he has say or influence in the exercise of his membership rights. (Tr. 464, Ls. 6-14).

14. Mr. Lidke is actively participating in his LLCs, by voting, reviewing LLC agreements and other materials, attending meetings and taking an active part at the meetings. He has also personally tested the dispatch communication system. He chose not to contact another radio but employed the system's ability to connect with the land lines. His conclusion was it was as clear as a normal phone conversation. (R. 7; Tr. 466; Tr. 468 through 470; Tr. 513, Ls. 20-22).

15. Mr. Lidke attended the Sacramento, California meetings of the various LLCs and told the story of what transpired at the "All LLC Meeting." He stated that Mr. Koenigsberg had offered his nomination to be the president of each of the LLCs. Another member/partner (from an LLC other than one in which Mr. Lidke is a member) spoke against the nomination. As a result Mr. Koenigsberg withdrew his nomination. Then, instead of electing a president, each of the LLCs decided to merely nominate a spokesperson to facilitate communication. (Tr. 466 & 467).

16. Also at the Sacramento meetings, the members discussed and were favorable to the formation of a WRN. Yet the first vote on the subject, which was to actually form the WRN, was defeated. Rather, the members, through their respective LLCs, voted to have FCC counsel draft a proper program for bringing about a WRN. Several weeks later, counsel reported back and several votes were issued following counsel's recommendations. (R. 8, *attached to proxy is the proposed six (6) step process to bring about a*

WRN; Tr. 470-474; *Mr. Lidke explains at 475, that since he is a member of several LLCs, he filled out one and sent it on with voting instructions for his other LLCs.*). The general proposal from counsel was to form "roaming" agreements between the several LLCs. This would be coordinated with the transfer of licenses (pursuant to the 220 Management Agreements) from the license holder to the LLCs. Later, after required minimum FCC loading and other requirements are met, they might transfer the licenses to a WRN. (R. 8: Tr. 475 & 476). He further commented that the formation of reciprocating agreements was common in the communications industry. (Tr. 486, Ls. 10-14). Mr. Lidke felt that if he wanted to make a motion at the meetings he could. (Tr. 494, Ls. 3-8).

a. The Sacramento, California meetings were also an opportunity to get informational presentations from industry personnel and suppliers. (Tr. 491).

17. At the Sacramento, California, LLC meetings, although they all met together, the LLC voting was done separately and independently. (Tr. 471, Ls. 22-25; Tr. 475, Ls. 5-8).

18. Mr. Lidke also described how he felt that if something is wrong about the way the business is being operated he could arrange to have a meeting to resolve disputes. (Tr. 477). In fact, some of his LLCs have held other meetings and if he wished not to attend in person he believed he could attend by telephone or proxy. (Tr. 477, Ls. 17-25 through 478, Ls. 1-21).

19. Mr. Lidke received a Membership Summary for each of his LLCs and decided to go forward with his investments. The Membership Summary did comport with what he understood the terms of his investment to encompass. (Tr. 479 to 480, Ls. 7).

20. Mr. Lidke has had no trouble obtaining any information from his LLCs. (Tr. 482, Ls. 8-11).

21. Mr. Lidke is satisfied with the performance of SMR Advisory at this time, but if he felt dissatisfied he knows he can have a meeting of the members and remove SMR Advisory. (Tr. 484). Further, SMR Advisory, Aks Daks nor Mr. Koenigsberg exercise any control over Mr. Lidke's decision making. (Tr. 485, Ls. 1-6).

22. **Prof. Williard Fey.** Professor Williard Fey, a witness for the Respondents, graduated from MIT with dual degrees in management and electrical engineering. While instructing at MIT's Sloan School, he worked in the field of dynamics, the study of how corporations and governments work. He has been an associate professor at Georgia Tech, since leaving MIT. At Georgia Tech he teaches in System Dynamics, specifically, Engineering Economy, which is essentially methods for analyzing investments. Prof. Fey consults with companies in business management and feels he has a good understanding of such. He also has a good understanding of the electromagnetic spectrum. (R-9; *résumé contained therein*). He is a member of (or holds in trusts for the benefit of his family) Fresno 220 Holdings I, L.C., Fresno 220

Holdings V, L.C. and Reno 220 Holdings I, L.C. (R. 11, 12, 14 & 15). Prof. Fey is responsible for certain trust funds for his family. Small portions of those trusts were designated to high technology investments associated with the information highway. (R. 10 & 13; Tr. 523-527).

23. Prof. Fey found Mr. Koenigsberg through a salesperson who told Prof. Fey about the SMR Advisory venture and put Prof. Fey in direct contact with Mr. Koenigsberg. (Tr. 528 & 529, L. 1).

24. At the time of his first communications with Mr. Koenigsberg, (February of 1994) Prof. Fey had the following to say about the partnership plans to go into the 220 MHz industry:

> [At the time of their first conversation, they did] . . . not only talked about the 220 megahertz opportunity, but we also talked about his philosophy, because it wasn't very well formulated at that point. He had the idea and, and he had some license holders, but he had never built out or contracted with people to build out such a system, and he really had not even structured organizations like these partnerships, these limited liability corporations – partnerships to do this. (Tr. 529).

* * *

> And as I talked to him, I discovered that he had the kind of management philosophy that I was really looking for as an investor because since I had a management background and was a consultant for corporations, it was my desire to participate as much as I could in the investments that I was making. I didn't want to just invest in something that somebody else was going to manage. (Tr. 530).
>
> * * *
>
> But it turned out in our conversations that Albert really was interested in other people participating and talking with them and becoming involved in it, and that was a very attractive kind of opportunity for me. (Tr. 530).

25. So, Prof. Fey found a company, SMR Advisory, were people had to work together to figure out and formulate, "what we had to do." (Tr. 531, Ls. 13-25). From the first formulations, though, the LLCs were individual enterprises, there was no concept of a network, or the WRN. (Tr. 539, Ls. 14-23). Sometime in June or July of 1994 the concept of a network began to develop. (Tr. 540, Ls. 1-13).

26. Prof. Fey did state, though, that, Mr. Koenigsberg did have some general ideas

about the structure of the partnerships or limited liability companies and had specified a certain number of units for a buildout and a price for them, and when the buildout was complete, he had specified a percentage of the total ownership that his organization, SMR Advisory would receive (eight percent (8%) of the value of the LLC for the successful completion of this installation), which Prof. Fey thought was a very reasonable number. (Tr. 532, Ls. 3-9). Prof. Fey further explained that in the usual circumstances of a buildout for a 220 MHz licensee, the contractor arranges to buy out the licensee when permitted. Mr. Koenigsberg's plan was to give the licensee twenty percent (20%) of the LLC. So the breakdown that was envisioned was seventy two percent (72%) to the licensee, the balance to SMR Advisory and the licensee. Thus, the plan was that everybody would eventually be a partner in its development. (Tr. 533, Ls. 4-14).

27. Prof. Fey instructed that this amorphous beginning is not unusual for partnerships from his experience in management. (Tr. 533, Ls. 18-23). What is unusual and incredible is that the LLCs have built out these forty (40) systems within one year. (Tr. 536, 4-14).

28. Prof. Fey from his experiences does not make a distinction with LLCs, as he considers his companies to be partnerships. (Tr. 529, Ls. 16-25). From the beginning he has always been treated as a partner, seeking

and giving advice which was always provided and taken. Mr. Koenigsberg and everyone else at SMR Advisory were always available. (Tr. 538, Ls. 18-24). He has also visited the offices in Sunrise, Florida and contributed his labors as a partner to the business. (Tr. 546, Ls. 1-10). He has also written his co-members to keep them informed about his activities on behalf of the partnership as well as encouraging them to put in their efforts. (R. 9; *particularly memorandum of February 27, 1995*).

29. Prof. Fey also gave the economic reasons why a network would be more valuable than holding a single 220-222 MHz systems, in that a wider communications span will attract more customers whose business develops over larger spans, thus enabling communications beyond the single site's broadcast range. (Tr. 542).

30. Prof. Fey attended the Sacramento LLC meetings and wrote a report to his other partners that included an overview of that meeting which took place on January 21-22, 1995, a presentation on the latest vote issues, and an update on the WRN resulting from the Sacramento meetings. (R. 9; *memorandum of February 27, 1995*). The All LLC meeting, according to Prof. Fey's memorandum, opened with presentation by Mr. Koenigsberg on the partnership vision and presentations by various equipment suppliers and industry officials, such as David Thompson, SEA International, Inc. a division of Data Marine, Inc., Victor Gonzalez, Dir. of International Sales, Trident Micro

Systems, Duncan Tompkins, Regional Manager, Celwave R.F., and others. Later that day a demonstration of the facilities and capabilities of the systems in operation. Saturday's presentation included discussions with attorneys, a report from MTA-EMCI, who estimated the value of the joint LLC-partnership endeavors, *see further, MTA-EMCI "Fair Market Valuation of Western Regional Network Prepared for SMR Advisory Group February 6, 1995, by MTA-EMCI, Washington, D.C., and testimony of S. Virostek, infra.* (R. 6; *See also, testimony of Mr. Koenigsberg, Tr. 1106 through 1124*). The formal voting meeting of the member/partners was held on Sunday. In Prof. Fey's words,

> The formal meeting of the partners to organize the 40 LLCs was held on Sunday afternoon. While there was a good bit of chaos; the partners' consensus was remarkable. Almost all were supportive, optimistic and committed to joining to form a network. The members finally agreed to organize, as the attorneys recommended, as individual LLCs; to acquire the 220 MHz licenses in exchange for equity (20%); to establish roaming agreements; to work toward becoming a network and a public corporation; and to continue to have SMR Advisory Group manage the construction and operation of the LLCs' equipment and business. It was a very positive, successful meeting. The partners met each other and the SMR staff.

They saw the system in operation. Pride in a job well done, optimism for a successful future, friendship and cooperation prevailed. (R. 9, February 27, 1995 Memorandum, *See also, Tr. 549 through 556*). He also explained at the meeting that Mr. Koenigsberg opened up to the many members saying "what do you want to do." At first, they all moved to form a network, then as discussions ensued they agreed not to at that time, but rather to have counsel chart a legally sufficient course. (Tr. 556). Prof. Fey also confirmed, albeit in different terms and perspective, the fact that Mr. Koenigsberg was first considered for president, but after consideration the members of the LLCs decided not to elect him. (Tr. 557; *See also testimony of Mr. Koenigsberg, Tr. 1124 through 1128*).

31. Prof. Fey revealed that the use of an outside compliance interview was his proposal. (R. 9, Letter of August 19, 1994, point 6; Tr. 560).

32. Prof. Fey described for the hearing the "VRU," or voice response unit (Tr. 1156, L. 18) an SMR Advisory program to further facilitate member/partner communications. Prof. Fey described it as follows:

> The VRU is voice response unit. It is a mechanism, a telephone interactive system, whereby the partner can telephone to a central location and be answered by a computer-driven system that talks with the partner, describes

proxies that are to be voted, and asks the partner to vote on those proxies; and the partner can then vote on them by voice from a telephone anywhere without having to mail a proxy in –

(Tr. 562).

receive a written one, and mail it in.

The computer can be programmed to actually call all of the members and tell them that a proxy is to be voted on and that the issues are whatever they are. So it's a, it's a communications system that is set up to be computer-operated – no person needs to be associated with it – that can collect information about the partner's wishes in a very short time.

It's a process that I know of no prototype anywhere for that. It's something that has been developed here to bring the partners' wishes into the system quickly and efficiently.

Q. Have you consulted with Mr. Jay Joslin and Mr. Jimmy Evans in the development of this interactive voting system?

A. To a small extent, I've interacted with them for that. I've interacted with them more for an extension of the

> system that is, in my judgment, extremely important, and that is a process whereby the partner can have access to all of the internal information about the operation, financial information, employment information, information about customers, the usage of the system and the billing for the system, complete information system that would be on line for any partner to call in and find out exactly what's going on in this system.
>
> (Tr. 563).
>
> A partner can't really vote proxies intelligently without a great deal of information about what the system is doing and education about what that means, and so this extended system will provide that information. It will also provide the education.
>
> It will explain to a partner exactly what is involved, what is a transmitter, what is an antenna, how does the signal get amplified, how does it get across from one frequency to another, how does the financial system work, how does the billing software work.
>
> (Tr. 564).

A demonstration of the VRU (and EIS) on the last day of the hearing confirmed the abilities of the system being developed as described by Prof. Fey. (Tr. 564; Tr. 1272 through 1316,).

33. As to the meaning of the VRU and EIS to the ability to function as a member/partnerships, [sic] Prof. Fey stated that its use in business among persons is unheard of, in that no one is as open as the member/partners are providing for, as it will provide access beyond what CEOs of many companies now have. (Tr. 565, Ls. 9-12). Mr. Koenigsberg stated about communication amongst the partners and the use of the VRU, "It's so important that we understand that we are, you – we are not in 1934 here. * * * We are in 1995, and, you know, transmissions are just being zipped across the world moment by moment. Okay. And with this tool, we will be able to have partners from around the world participate in running a business moment by moment." (Tr. 1157, Ls. 15-22).

34. Finally, Prof. Fey described that the systems are up and running in that the systems have their transmission equipment installed and it is sending and receiving signals. (Tr. 587 to 588, Ls. 1-15.) Like Mr. Lidke, Prof. Fey does not expect profits for a year. (Tr. 588, Ls. 14-17).

H. Expert Witnesses

1. **Dale Hatfield**, CEO of Hatfield Associates, Inc. stated he was at the hearing on behalf of the ACC to give expert testimony on land mobile radio and to analyze the risks of the business plan. (Tr. 669, Ls. 14-25). Mr. Hatfield has an electrical degree in industrial

engineering from Case institute for Technology and industrial management master's degree from Purdue University. He began his career some thirty years ago at a manufacturing plant then to the Central Radio Propagation Lab in Boulder, Colorado for the Department of Commerce. He had a sojourn with the White House in the Office of Telecommunications Policy, and from there to the FCC, where he eventually became head of Plans and Policy. He then returned to the Department of Commerce for policy and research issues and finally, to the office of policy and development in the National Telecommunications and Information Administration. (Tr. 671, Ls. 13 through 673, L. 1). Mr. Hatfield also teaches adjunct courses at several universities and colleges. (Tr. 673, 18-25). He has experience at the FCC in the 220 MHz and narrowband industry. (Tr. 674, Ls. 20-25 through 676).

2. Mr. Hatfield came to testify on three issues: 1) background on the industry, 2) whether the business plan adequately disclosed the risk incidental to the plan, and 3) and whether ordinary investors could be expected to participate in the business. In his introduction, Mr. Hatfield failed to candidly reveal that a telecommunications company for which he was a Board member, was potentially threatened by competition that may come from the success of SMR Advisory and its affiliated LLCs and their business in the 220-222 MHz industry. (Tr. 737, Ls 16-25 to 738, Ls. 1-25). That company is Pittencrieff Communications, Inc. ("Pittencrieff"). Further, some of his statements

made against the business of SMR Advisory's product line, were the subject of an article he published in "Nationwide Networks," (R. 18). His statement in the article and those made to the ACC are diametrically opposite and no proper distinction was provided for this difference.[4] When confronted with many of these inconsistencies, his answers were anything but responsive. *(See generally, Tr. 737, Ln. 16 through 743, Ls. 1-10; Tr. 761, Ls. 16-25 through 765; Tr. 765-769; Tr. 772 to 775, L. 1).* Some of the assertions made by Mr. Hatfield were pointedly and directly contradicted by the Respondents' expert as to system valuation, Stephen A. Virostek, whose statements are found to be based in more demonstrative analysis than the analysis provided by Mr. Hatfield.

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[4] For example, Mr. Golestani commented in his testimony that an advantage to 220 MHz transmission is that it is superior in rocky, not flat terrain. (Tr. 637, Ls. 8-13). Mr. Hatfield, in R. 18, his article stated likewise about the 220 MHz wavelength, "The new 220 MHz bank is one of the best for mobile operation because of its superior coverage, particularly in rough terrain. Lower frequencies do not require transmission paths to be as close to the line of sight as do the higher frequencies; therefore, the 220 MHz band is superior to the 800 and 900 MHz specialized mobile radio (SMR) bands in this respect." (R. 18, at 52). But when asked about Mr. Golestani's testimony cited above, he answered, among other things, that, "Beyond that, then there is a number of other – a number of other significant disadvantages to – technical disadvantages or constraints produced by operation of the 220." (Tr. 698, Ls. 17-20). That answer was made before he was confronted with his article. (R. 18).

3. Taking the issues Mr. Hatfield attempted to testify about in reverse order, the challenge that the LLC members could not participate competently in the LLCs business is "vacuous." (An interesting statement in light of the very capable customer/members who testified at the hearing for both the State and Respondents.). The State cannot deem that some people are more adequate than others in achieving business results, in advance of performance. (Especially in light of the fact the LLCs subject to this proceeding have performed well). (Tr. 686, Ls. 2-25; 689, Ls. 13-25).

4. Second, any value that should be provided Mr. Hatfield's testimony based on his most admirable career and obvious command of the field of telecommunications is diminished in his attempt to testify that the risk disclosures provided by the Respondents were deficient. (Tr. 696 through 734). Actually, it would be difficult to expect any business to provide more or more thorough disclosure than was provided by the Respondents in this matter. Further, in his testimony, Mr. Hatfield indicated that certain disclosures were not made. Yet, many of the factors Mr. Hatfield spoke about were disclosed. For example, the section on, "No Assurance that the System will be Completed and in Operation by the FCC Deadline; Potential Loss of Entire Capital Contribution", found in the Brick. *See list beginning at page, 5, supra.* (Tr. 727; For

longer list of things claimed not to be disclosed, which were disclosed, *see,* Tr. 795, Ln. 19-25 through 805[5]).

5. Finally, whether Mr. Hatfield's testimony on the future value of the radio technology being employed by the Respondents and their affiliated LLCs is accurate, is not material to the issues in this proceeding. The ACC does not value or rate competitive goods and services. Other than to disparage the extent of the disclosed risk, Mr. Hatfield's testimony merely attempted to claim other available services are better. Perhaps this is true. The issue at hand, though, is whether the Respondents sold an unregistered security interest. Whether another radio technology is better for some purposes is not material to the issue. Further, even if fraud were committed by Respondents (and none is found in these proceedings) unless the fraud was pursuant to the sale of a security, the fraud is not of concern to the ACC, at least not of a concern for which it is empowered to act.

6. In the end, Mr. Hatfield had to admit that 220 and 800 MHz are comparable for dispatch. (Tr. 766). He also admitted that he knows of no one else who has been able to

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[5] Incredulously, during the interchange between Tr. 792 and 805, the witness first says he read the Membership Summary, then only certain sections and skimmed others. Among the "skimmed" sections included the bold type, including the bold type on rescission, *i.e.* it cannot be gleamed from his testimony that he knew the prospective member could rescind.

build out as many as forty 220 MHz systems. (Tr. 800, Ls. 2-5), much less in a period of one (1) year.

7. **Stephen Virostek.** Mr. Virostek is a Senior Consultant, with Malarkey-Taylor Associates-Economic and Management Consultants International, Washington, D.C. The enterprise is referred to as MTA-EMCI. MTA-EMCI is a full service telecommunications consulting company. It provides a wide range of proprietary consulting services including strategic business planning, market demand studies, economic analysis, market research, litigation services and financial analysis. MTA-EMCI is also a prominent publisher of market studies covering the SMR, cellular, cable television, PCS, mobile data, and paging industries. Some of the MTA-EMCI publications that Mr. Virostek himself either wrote or were completed under his auspices are, "Analysis of the Impact of FCC's Wide Area SMR Licensing Proposal on the Business Radio Market (*see R. 20*), U.S. Mobile Data Marketplace, European Mobile Data Marketplace, Wireless Office Telephones, and Licensed PCS Market Study. (R. 20, 23: Tr. 950 to 956, Ls. 1-7). Before securing Mr. Hatfield as its expert witness, the State of Arizona attempted to secure the services of MTA-EMCI to be the State's expert witness. At the time of the State's offer, MTA-EMCI had already accepted and executed a study on behalf of some of the respondents, *to wit.*, "Fair Market Valuation of Western Regional Network (WRN)", February 6, 1995 ("Fair Market Valuation"). (R. 22; Tr.

956, 8-22). Mr. Virostek was qualified as an expert on the economics of SMR. (Tr. 957, Ls. 7-17).

8. Among other projects, each year in conjunction with American Mobile Telecommunications Association, or AMTA, MTA-EMCI conducts a survey of SMR operators across the United States. The survey compiles data on the types and number of subscribers, services, price of services, and radio units in the marketplace. That research constitutes a database which becomes the source of market studies for their clients. The article describing the 1994-1995 study is contained in the evidence. (Tr. 950, Ls. 23-25 to 951, Ls. 1-13). Also provided as evidence through Mr. Virostek, was his study, "Analysis of the Impact of FCC's Wide Area SMR Licensing Proposal on the Business Radio Market, January 5, 1995." The FCC solicits comments from a variety of participants in the industry to help with rule making. This report found that the total number of SMR units in service to subscribers to day are 1.8 million, for an annual growth rate of eighteen percent (18%). Major growth came in the dispatch-only operator's market, to 1.4 million or seventy nine percent (79%) of the SMR market. The report also contained data on small verses large operators, the price of service, and the future for the industry. Although the report indicates that the majority of revenue comes from dispatch-only service, it recognized a rising price every year for interconnect service, although the rise has recently flattened. Finally, the report added that to increase

service revenues providers are increasingly seeking new alliances to accelerate growth. (R. 20 and 21; Tr. 961).

9. The intended use for 220 MHz was dispatch services, yet for a variety of reasons the operators have expanded from the original dispatch service to provide interconnect and some data services. It is believed this trend will continue to evolve. Comparing the 220 MHz to the 800 and 900 MHz markets, and based on his industry interviews, Mr. Virostek had determined that the 220 MHz industry intends to provide similar services. (Tr. 962, Ls. 13 to 963, Ls. 1-21).

10. Mr. Virostek reported, contrary to Mr. Hatfield, that there are now four (4) competitive equipment vendors providing product in the 220 MHz industry. (Tr. 962, Ls. 13 to 963, Ls. 1-21). Also in disagreement with Mr. Hatfield's testimony, Mr. Virostek had learned from manufacturers that if there is demand, 220 MHz fully duplexed systems and phones can be developed. It would just be a matter of technology advancing. (Tr. 977, Ls. 22-25 to 978, Ls. 1-11) Finally, concerning Mr. Hatfield's testimony as a whole, Mr. Virostek made the following comments:

> A. The two basic conclusions that I reached in reading his [Mr. Hatfield's] testimony is that there's generally a confusion between the two different markets and two different services we are talking about here. The two markets are, one, the dispatch

market, or the one-to-many communication, and number two, the
(Tr. 978)

market for mobile telephone service, which is similar to cellular.

There were a number of instances where Mr. Hatfield referred to trends in cellular market, and I wanted to be clear on the Court's behalf that this is a, is a very different market.

The subscribers in the cellular market are typically individuals, where the subscribers in the dispatch market are typically businesses. I've already documented the difference in price of monthly services between interconnect and between dispatch pricing.

There's a very significant difference between prices of mobile radios and the prices of mobile telephones, and there are some other differences as well, which this court should keep in mind in moving through the information presented here.
(Tr. 979).

Later, Mr. Virostek added the second conclusion,

A. Yes. There were a number of misstatements about the 220 megahertz equipment market that I thought needed clarification. There were some questions as to whether high-quality equipment could be produced, and certainly it's been my experience to test out some 220 megahertz equipment, and I found that it has been high quality relative to 800

(Tr. 980).

megahertz SMR technology.

There was a statement that 220 megahertz is not heavily deployed. That statement – it depends on where you stand, what your definition of heavily deployed is.

There are systems – and I think SMR Advisory Group has testified as to the number of systems, 200 channels up on the West Coast. There are a number of channels in Philadelphia and New York and a number of channels in Florida. There may be some instances in Cincinnati, Ohio, and Cleveland, Ohio, so it's not as if there's only a few operational systems.

There's, to my knowledge – I forgot Wireless Plus and ICC in the California markets. To my knowledge, there's at least, at least 10 operators operating 220 megahertz system

in different portions of the country.
(Tr. 981)

Immediately thereafter, responding to an inquiry about Mr. Hatfield's statements that manufacturers cannot build high quality equipment for the 220 MHz industry, Mr. Virostek stated that Mr. Hatfield was wrong. He based this conclusion from first hand knowledge and actual use of the communications system. (Tr. 981, Ls. 16-25 to 982, Ls. 1-4). Finally, at page 117, line 12 (in the expedited copy; page 779, Ls. 12 in the final copy), Mr. Hatfield said that no major manufacturers of mobile equipment are present in the market. Mr. Virostek, disagreed and pointed to Uniden and E.F. Johnson, as major manufacturers in the SMR markets. (Tr. 983).

11. Mr. Virostek testified that local broadcasters have, at least of late, been combining into larger systems. Examples included, Nextel, Mr. Hatfield's company, Pittencrieff, One-Com Corporation and Dial Call, Incorporated. It seems that the economics of the industry give greater deference to systems that have more channels in wider geographic areas. This is one can now serve larger numbers of subscribers, hence, enhancing revenue streams and thus, economics of scale. (Tr. 966 to 967, Ls. 1-9).

12. The Fair Market Value report, Figure 2.1 was constructed from the propagation studies done by SMR Advisory. Figure 2.1 indicates the tower site locations for the licenses subject to this proceeding. They also provide a forty (40) mile radius view of

the areas covered by each of the systems. The selection of the forty (40) miles circle, did not have to do with the FCC's forty mile rule. That rule is Subpart T, providing for a limitation on a single owner in a given area holding more than one license in a forty (40) mile area. (Thus, because of overlapping circles on the diagram, implicitly, the WRN could not exist as an entity comprised of the forty [40] systems making up the WRN without violating the forty mile rule, at least not without the FCC's authorization of an exemption.). (Tr. 967, Ls. 17-25 to 969, Ls. 1-6).

13. Mr. Virostek also defined roaming as the ability to use your mobile radio outside of your home service area. Where available, roaming would contribute to the value of a system. For the systems subject to this proceeding to participate in a roaming agreement, they would need to enter into some convention with each other, and as of the date of his testimony, Mr. Virostek did not know of such an agreement. (Tr. 970 to 971, Ls. 1-14).

14. On January 10, 1995, MTA-EMCI was hired by SMR Advisory on behalf of its LLC co-member/partners to valuate a WRN, comprised of all the forty (40) licenses. Mr. Virostek then defined "fair market value" as the cash price a willing buyer would pay a willing seller for an exchange of assets. Both parties in this transaction would be assumed to be operating under complete disclosure, full information, and neither party would be compelled to buy or sell the

assets in question. (Tr. 963, Ls. 18-25 to 964, Ls. 11; Tr. 964, Ls. 17-20). To make this determination, MTA-EMCI undertook three steps. First, to determine the potential growth in subscribers for the properties, what revenues will be generated and what expenditures this will initiate. To reach these compilations, MTA-EMCI undertook a demographic study to assess the demand characteristics of the relevant areas. They looked at three (3) basic demographic measurements; population, business and household income. In addition, they also looked at the channels of the proposed network versus the number of subscribers per area and the likelihood of successfully loading the network. To those numbers they added a subscriber forecast for the next ten (10) year period. At that point, Mr. Virostek, with a colleague, Andy Gefen, developed a financial model to produce future cash flows, which in turn were discounted back to present time value to come up with a fair market value. (R. 22, items 1.2.1 through 1.2.4; Tr. 923, Ls. 23-25 to 965, Ls. 21).

15. MTA-EMCI found the fair market value of the forty (40) systems, if networked to be six million six hundred thousand dollars. ($6,600,000.). (R.22; Tr. 971, Ls. 20-22).

16. ***Larry Edward Ribstein***. Prof. Larry Edward Ribstein, the Respondent's witness concerning LLCs and questions of securities matters, particularly the definition of what is an investment contract and how it should be discerned in the presence of an LLC, is a foundation professor of law, George Mason

University, School of Law, Arlington, Virginia. His credentials include, but are not limited to: teaching courses in corporations, securities, agency and partnership, and business planning; coordinator of corporate and securities law track, regular speaker at both practitioner conferences/CLE programs and academic programs; and in the three (3) months prior to his testimony, he has spoken at academic conferences, including AALS, on corporate law, and LLCs, ALI/ABA on securities law-Business Law Section on partnerships and LLCs; he has also participated in the drafting of Georgia general and limited partnership laws; served on Virginia bar committees relating to Virginia partnership and LLC laws; worked as advisor to RUPA, including the final revisions in the past two months, and on the ABA ad hoc committee on RUPA; he authored a casebook on business associations, including partnership and securities; co-author of Bromberg & Ribstein treatise on Partnership; and co-author of Ribstein & Keatinge on LLCs. He is generally considered the leading expert in the country on LLCs and partnerships, having read several thousand partnership cases and studied and catalogued all LLC statutes; his role in drafting prototype LLC acts, provisions of which now are enacted in several states; and his articles on topics including tax classification and aspects of choice of form; tax classification and limited liability and aspects of choice of form; an overview of

LLC's; and a leading article on general partnership interests as securities, and is currently drafting extensive articles on evolution of LLC statutes and LLC interests as securities. (R. 25, Tr. 1170 through 1172).

17. Prof. Ribstein explained his discerning analysis of the state of the understanding as to what may be qualified as a security under federal law, as follows:

    a. In *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), the Supreme Court of the United States defined an "investment contract" as a "transaction . . . whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." General partners, are individually responsible for securing the information necessary from their partnership and other individual partners, that each may deem necessary to enable his/her/its participation in the partnership. The securities laws, on the other hand, particularly the federal securities laws and most of the state laws insure to each investor (who unlike a partner probably will not be taking an active interest in the businesses decisions and otherwise) equal access to all relevant information. The purpose of the Howey test is to identify from the standpoint of 'economic reality' the circumstances in which participants in an investment transaction are likely to need the information provided by the securities laws. Those circumstances include reliance on the efforts of a promoter or entrepreneur rather than the investor's own efforts, so that the investor needs specialized and detailed information about that promoter that would enable him to evaluate the investment. (Tr. 1177, Ls. 22-25 to 1187, Ls. 1-15).

b. The third, so called "prong" of the *Howey* test (efforts of others) is further conditioned where the transaction under analysis is a partnership. In the seminal case of *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981), the Court held that there is an "extremely difficult factual burden" to establish that a general partnership interest in a security. Specifically, the proponent of the presence of a security in a general partnership transaction must establish that (1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers. Under this test a general partnership interest was held not to involve a security. (Tr. 1187, Ls. 16-25 through 1189).

c. In reasoning out the logic behind their decision, the *Williamson,* court emphasized the investor's expectations based on partnership law, would result in the investor expecting that he\she\it had such significant ownership rights, that a presumption exists that the investor is not buying a security. Specifically, the court said that:

> " . . . although general partners and joint venturers may not individually have decisive control over major decisions, they do have the sort of influence which generally provides them with access to important information and protection against a dependence on others. Moreover, partnership powers are not in the nature of a nominal role in the enterprise which a seller of investment contracts would include in order to avoid the securities laws; on the contrary, one would expect such a promoter to insist on ultimate control over the investment venture. *An investor who is offered an interest in a general partnership or joint venture should be on notice, therefore, that his ownership rights are significant, and that the federal securities acts will not protect him from a mere failure to exercise his rights.* (Emphasis added.) (Tr. 1190 to 1192, Ls. 1-12).

Thus, the Court relied primarily on what an investor would expect based on the structure of the partnership relationship.

d. Further relevant case law comment on general partnerships can be found in, *Goodwin v. Elkins*, 730 F.2d 99, (3rd Cir. 1984). The Court therein, said, in analyzing the Uniform Partnership Act (existing in one form or another in substantially all states), that a general partner is:

   "unavoidably, even if unwillingly" part of the enterprise – that anyone with powers under the partnership acts . . . cannot have invested his capital with the expectation of profits derived solely from the efforts of others, and therefore cannot be the holder of a "security" as intended by the partnership acts. Whatever subjective perceptions Mr. Goodwin may have had about his position in the firm, and whatever may have been the role he actually assumed, the legal interest which he enjoyed does not fall within the scope of the term "security" as intended by Congress."

   Concerning the matter that a particular partner may have little power because there were so many partners, the *Goodwin* court, per Judge Garth, stated:

   "The argument that an investor who was only one of many general partners would have such a diluted interest in the enterprise that his role would become analogous to that of a corporate shareholder is also unconvincing. *See Williamson*, 645 F.2d at 423. If we were to consider a large Wall Street law firm with 54 partners, as contrasted with a small close corporation of only 20 shareholders, we still would find the latter to comprise a "security" but not the former. General partners, no matter how many or few they may be, are still, as a group, legally responsible for the management of the firm. Shareholders, however, no matter how many or few they may be, have a legally circumscribed role in the management of a corporation. State corporation statutes uniformly invest exclusive power to manage the ordinary business affairs with the Board of Directors, and indeed the very concept of a corporation is one in which the control of assets is divorced from ownership. (From footnote 14, in opinion.)" (Tr. 1192, Ls. 13-25 to 1196, Ls. 1-14).

e. Further, in perhaps the most important case relating to the transactions with which we are dealing may be, *Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc.,* 840 F.2d 236. In *Rivanna,* former Justice Powell stated in a footnote, of that opinion, "If and to the extent that Williamson and other cases may be read to require a court to look to the actual knowledge and business expertise of each partner in order to assess his or her individual ability intelligently to exercise the power of a general partner, we do not agree. Such an inquiry would undercut the strong presumption that an interest in a general partnership is not a security. It also would unduly broaden the scope of the Supreme Court's instruction that courts must examine the economic reality of partnership interests."

Justice Powell went further, in footnote 10, and added: "In a word, a general partner is not dependent only on the degree of his own business sophistication in order to exercise intelligently his partnership powers." Thus, general partners, rely on themselves to run their business, and an analysis of whether they are capable, is not a matter of looking at any one individual partner, but the collective talents of the partners as a whole.

f. Specifically omitted from replicating herein, is Prof. Ribstein's comments on the ninth circuit case law, which is not made herein as a finding, as Ninth Circuit cases apply the other case teachings to specific situations, such is better left for legal discussions then stated as a finding.

g. *Williamson* and related cases do not state a rule separate from *Howey*. The issue in partnership cases, as under *Howey*, is still whether investment contracts are securities, and the basic test is the last prong of the *Howey* test, i.e., the efforts of others factor. Williamson and related cases simply set forth a judicial rule that interprets "efforts of others" in a particular subcategory of cases – general partnership interests – in which common circumstances based on partnership law, direct a substantial burden against a partnership being a security. This is an application of the principle of *stare decisis*, just as courts in all areas commonly develop rules that guide decisions in later cases. This helps provide for predictability and ease of adjudication. (Tr. 1207 to 1215, Ls. 18).

h. The partnership reasoning and thus, the presumption that partnerships are not securities should be adopted for LLCs which are essentially general partnerships with limited liability to paid in capital. The important question is whether there are sufficient differences between LLC's and partnerships that the form of the investment would be deemed to provide categorically less participation in control. First, it is important to recognize that LLC's originated as a way of securing partnership tax treatment with limited liability. In light of this tax analysis, investors would **expect** they're similar to partnerships. IRS ruling in 88-76 to this effect was important event in popularization of LLC. This invokes the expectations policy of the Williamson and other cases.

Second, all of the important elements of participation in control that are present in partnerships are also present in LLC's. There is the same flexibility of management, which permits members to participate directly in control, the same limitations on transferability which ensures that there will not be large publicly traded LLC's, and the same default rule of dissociation and dissolution at will, which permits LLC members to terminate any managerial authority that may exist simply by withdrawing and/or dissolving.

Third, the tax laws suggest that LLC's will, in fact, be managed in critical respects by members. They provide that a firm that has limited liability must have at least two of the other three partnership characteristics – restricted transferability, decentralized management and no continuity of life. Because of the uncertainty inherent in applying these rules, firms will be unlikely to have clearly centralized management and gamble on the IRS accepting that the other features qualify. A firm that does have centralized management would have to clearly restrict transferability, which would impose a substantial risk on members unhappy with management. Thus, it is interesting that the Membership Summary provided in these transactions, stresses lack of centralized management. This is consistent with investor expectations.

Fourth, even in centrally managed LLCs, (the ones in these transactions are not centrally managed) LLC members will remain involved in management because of the inherent restricted transferability of LLCs – they can't simply sell out if they're dissatisfied. It is highly unlikely that they would ever allow a firm with freely transferable interests to be taxed as a partnership because this would eliminate any distinction between public and close corporations and open the former to partnership tax treatment. This is the principle underlying Section 7704 of the tax code. Thus, as long as partnership taxation remains an important motivation for LLCs they will retain this critical characteristic of closely held, active management firms.

Fifth, it is difficult to understand why, if investors want centralized management, they would not form a limited partnership and get very centralized management together with partnership tax treatment. In other words, why form an LLC for centralized management, particularly given the current uncertainties concerning the form, and unavailability in some states? The answer is that LLC members want the flexibility of being able to participate in management.

Finally, LLC members can be nicely distinguished from limited partners. Limited partners, as every even moderately experienced investor knows, may not participate in control of the business. While it is true that LLC members often delegate some power to managers, the critical point in a limited partnership is that the members *may not* participate in control without jeopardizing their limited liability. This is a very important protection for creditors of the firm, who want some assurances that on the eve of insolvency the members won't take over the firm and dissipate assets to save their investments. LLC members presumably pay higher credit charges to get this important right that limited partners give up. (Tr. 1216 to 1223, Ls. 1-7).

Although LLC owners have some powers that limited partners and corporate shareholders also have, the same is true of general partners. Section 303 of the Revised Uniform Limited Partnership Act ("RULPA") *seems* to give limited partners the power to, for example, remove general partners and approve contracts, just as LLC members have. But Section 303 of the RULPA, which does not give *any* power to limited partners, but simply provides that if the agreement gives these powers to limited partners, they won't lose their limited liability. Section 302 of the Act provides that limited partners have no powers other than those given them by the agreement. This contrasts with most LLC statutes, which give members the power to manage as a matter of statute. Anyway, even if the powers under Section 303 are relevant, they're still different from LLC's. Limited partner powers are only *negative:* they can veto very important acts and in extreme cases remove managers and serve in non managerial capacity. In any LLC, members can be managers, make contracts and initiate other business, and regularly elect managers. Most importantly, under many statutes, including the Texas statute which is relevant here, members, like partners, retain the power to bind the firm even if they delegate some internal authority to managers.

With regard to the differences between LLC's and corporations, corporate boards may resemble management committees of LLC's, and corporate shareholders don't necessarily give up their limited liability by participating in management. But a corporate board differs from an LLC management committee. Among other things, by statute, the board has the exclusive power to initiate important actions such as asset purchases. Thus, control, completely isolated from ownership, as emphasized in *Goodwin*. It is also critical that shareholders have no power to dissolve at will or to dissociate at will. Instead, the corporation relies on unrestricted transferability. A publicly traded firm almost necessarily has passive owners, since they trade participation in management for a right of exit. This puts a premium on having information out there in the market to evaluate management. (Tr. 1224 to 1243).

18. ***Prof. Marilyn B. Cane.*** Prof. Marilyn Cane, the Respondents' witness is a

professor of law at Nova Southeastern University, Shepard Board Law Center. Prof. Cane graduated Cornell University, magna cum laude with a major in history. She attended Harvard Graduate School for a degree in archaeology and graduated from Boston College Law School, where she was a member of Law Review and a member of the Order of Coif. Upon graduation she worked for Reavis & McGrath (now named, Fulbright and Jaworski). She then moved to Connecticut and worked for Badger, Fisher Cohen and Bennett. At each position she worked in the area of securities, but at Reavis & McGrathe her concentration on securities litigation was more pronounced. She next took a position with General Electric, at its headquarters in Fairfield, Connecticut, where she was mainly responsible for securities regulation reportings. Upon moving to Florida she went to work for, Gunster, Yoakley, Criser & Steward, again, concerned mainly with securities and corporate law matters. In 1983 she began her teaching endeavors and in 1988 became a full professor. She has written the Securities Arbitration and Law Procedure treatise. Prof. Cane has written a plethora of articles and most recently one on the Revised Uniform Partnership Act, that appeared in the Journal of Partnership Taxation. She also has recent securities publications in the Journal of Corporate Law and the Harvard Journal of Law and Public Policy. She has also written on Florida's blue sky law, which appeared in the Nova Law Review.

She was last year's Chairperson of the Florida Bar Securities Committee. Prof. Cane was recently offered a contract with West Publishing to write the corporations textbook for the State of Florida. Finally, Prof. Cane has been called as a witness on behalf of the State of Florida, regarding securities matters. (Tr. 858 through 862).

19. Prof. Cane determined from her studies that Arizona state courts look to federal interpretations for methods to determine what may be a security. Particularly, Arizona directs examining the *Howey* criteria. Prof. Cane's description of *Howey* is materially and substantially alike Prof. Ribstein's discernment. In Prof. Cane's words, though, she directs the "touchstone" of the analysis is access to information and control. Prof. Cane, as Prof. Ribstein, relied heavily on the analysis and arguments of Ninth Circuit cases, but as in the findings on Prof. Ribstein, no findings will be made on those cases, but left to the conclusions of law. Given that we are dealing with either partnerships or instruments like partnerships, she also directs that the efforts of others aspect of *Howey,* must be examined under the teachings of *Williamson*. She interprets that case as creating a heavy burden to overcome in circumstances where partnerships or partnership like entities are alleged to be securities. Prof. Cane then applied the teachings to the powers and requirements of the Membership Summary. Her conclusion was that the articles and regulations of the LLC leave much power and control in the hands of the members and provide for

the necessary access to books and records. Prof. Cane also added that it is not violative of the reliance on others prong, to hire expertise, as a principle, as opposed to conveying all rights to a third party to employ one's capital. (Tr. 875 through 892).

20. Prof. Cane described the concept of "bespeaks caution" a doctrine that applies to securities but should likewise apply in non-security situations. The doctrine holds that, a court may determine that the inclusion of sufficient cautionary statements in a prospectus renders misrepresentations and omissions contained therein non-actionable. Further, that a statement or omission must be considered in context so that accompanying statements may render it immaterial as a matter of law. When a disclosure contains abundant warnings and cautionary statements which qualify statements that may have been relied upon, it cannot be contended the buyer was misled. (Tr. 892 through 900). Prof. Cane then takes the doctrine and matches it favorably to the many and extensive risk disclosures found in the Membership Summaries at hand. (Tr. 901 through 907).

21. Prof. Cane instructed that the neither the Uniform Partnership Act, nor the Revised Uniform Partnership Act requires that a writing be filed. (Tr. 945, Ls. 17-23). Two or more persons joining as owners to carry on a business for profit is a partnership. (Tr. 946, Ls. 1-4). The participants in the reservation process before subscribing to be members of the LLC and pursuant to delivery of

the Brick could be characterized as partners. (Tr. 946, Ls. 5-9). There is no magical number of members beyond which you cannot form and act a general partner. (Tr. 946, Ls. 10-12).

22. ***Jay Valinsky.*** Jay Valinsky, the Respondent's witness, is an attorney of law with the law firm, Kipnis, Tescher, Lippman, Valinsky and Kain, P.A. He received his degree from Albany Law School, and took his final years at Fordham University School of Law. From 1980 to 1986, he was Assistant General Counsel, Bear Steams & Company. In 1986 he joined the law firm of Atlas, Perlman and Trop, P.A., as a partner. In 1993, he and his partners started his present firm. His practice is in corporate and transactional securities work. On behalf of said practice he has done both public and private offerings, the public offerings being filed under the Securities Act of 1933 and has dealt extensively with most states' blue sky laws. In Arizona, he has filed on behalf of issuer clients private placement offering memorandum. He has also been involved with public offerings requiring appropriate documentation with the ACC. (Tr. 10 17, Ls. 21, to 1020, Ls. 1-3). Mr. Valinsky was previously employed by Aks Daks on behalf of the LLCs to review the Membership Summary and add substantive comment. Specifically, based on his prior private placement and public offering experience, to focus upon and "beef up" the risk factor section to further disclose those factors in accordance with historical practices. (Tr. 1020). He understands that he may, in the near future be hired by the LLCs

subject to this proceeding to investigate the efficacy of a public offering. He didn't know whether he would be so hired, as the vote to hire his firm, was then out to the membership to vote upon. (Tr. 1021, Ln. 4-17). Mr. Valinsky also attended the Sacramento meetings. (Tr. 1027).

23. Pursuant to his duties on reviewing the Membership Summary (December of 1994) for risk disclosures, he came to learn much about the companies discussed therein. Mr. Valinsky characterized the initial formation days of the transactions subject to this proceeding as a general partnership among the initial participants. (Tr. 1026 & 1027, L. 14 & 18-22; Tr. 1053, Ls. 13-20). His assumption of a general partnership exists because even though the original solicitees held only reservations, they still voted, and thereupon directed the course of the various enterprises development, *i.e., the Class B members, before acceptance into the LLC were general partners with the LLC and its then, Class A members.* He understands that this partnership originates to the February-March 1994 time period. (Tr. 1029, Ls. 18-25 to 1030, Ls. 1-21).

24. When the membership/partnerships undertook its original efforts they faced a December 2, 1994, construction deadline, pursuant to FCC regulations. (Tr. 1030, Ls. 16-25 to 1031, Ls. 1-6). Mr. Valinsky concluded, given the newness and monumental task of the business the early partners would come to develop, they could not have found a

broker/dealer and could not have comported with the requirements of the '33 and blue sky acts in time to complete registration requirements and meet the construction deadlines. (Tr. 1035, Ls. 4-13).

25. The WRN forecasts found in S.77 and those in R. 22, differ and both were provided to solicitees during the development of the business, albeit, that it seems as S.77 was provided in the early days of the business, whereas R. 22 was provided to the membership coincidental to deciding whether to accept membership or rescind participation. S.77 was prepared by the Respondent's certified public accountants and contains the appropriate accounting disclosures, such as;

> . . . there will be many differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material.

Then later in the report it also states:

> The assumptions disclosed herein are those that SMR [Advisory] believes are significant to the forecast. There will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. The forecasts were prepared for the purpose of presenting the Western Regional Network's future operating results and not to present the value of the organization.

Note is taken that the MTA-EMCI report (R. 22) was a report on the "present value" of the system, just what the Respondents' S. 77 claims not to be. Additionally, the expertise of MTA-EMCI cannot possibly have been replicated by SMR Advisory in its early beginnings. Finally, the disclosures warned of variances, and the prospective members had the opportunity to examine the differences before going forward on their reservations. (Tr. 995-998 & 1037; *See also, Tr-1149, as to origin of S. 77 numbers and Tr. 1149 through 1154, L. 1)).*

I. SMR Advisory Members

1. ***Jian Golestani.*** Presently Mr. Golestani is a vice president and members of SMR Advisory. (Tr. 593, Ls. 9-24;). Mr. Golestani, graduated from the University of Wales, Institute of Science and Technology, with an honors degree in electronic engineering. He is also a Chartered Electrical Engineer, of the British institution, the United Institute of Electrical Engineers, which is a guild status obtained by institute monitoring for three or four years of work product. His first position out of school was for Plessy Major Systems, Inc., (a large European manufacturer of electronic equipment from satellites to consumer products) where he designed hardware and software that became British Telecom's switching network or integrated service (or the ability to connect caller A with caller B). He then tested the product under British Telecom's auspices. Thereafter he took a position with

Siemans and worked in the Belcor Labs (formerly AT&T's research labs). Included in those duties were networking software design. Next,, he went to Alcatel, and he designed GSM, group special mobile, the European cellular integrated service, which dealt with the 900 MHz section of the spectrum. That along with 800 and 220 make up the SMR communication frequencies. From Alcatel, he entered into his own partnership business, which failed and taught him to be cautious about partnerships. He returned to Siemans, with special permission from the company as usually Siemans does not rehire. (Tr. 598 through 603, Ls. 1-10). That's where he stayed until 1994.

2. A friend had suggested that Mr. Golestani contact Mr. Koenigsberg who had just set up SMR Advisory and seek employment. He came for an interview, but instead Mr. Koenigsberg suggested he just come to work for a few days so the team could get to know him and he they, to determine whether they could be productive. (Tr. 604, Ls. 10-25). The "team" decided that he would be a benefit and he joined the team. At SMR everybody gets an income and a percentage of profits. "Most people, at SMR Advisory, including myself, who have come on board have either held jobs that are highly paid in the past or better paid than they are right now." (Tr. 605, Ls. 10-17). The SMR Advisory partnership is made of many people with diverse talents and all vote equally. (Tr. 631 through 634).

3. When Mr. Golestani joined SMR Advisory, Mr. Koenigsberg did not know anything about building a Business Communication System or any other SMR facility. (Tr. 606, Ls. 6-13). When Mr. Golestani joined the member/partners of SMR Advisory, he knew very little about running a business. (Tr. 606, Ls. 16-21). Mr. Golestani explained that during the fourteen (14) months that they have known each other, as partners, Mr. Golestani and Mr. Koenigsberg have taught each other about the other's expertise, and the other partners have done the same for each other while building the company. (Tr. 606, Ls. 21-25, to 607, Ls. 1-2).

4. Mr. Golestani joined SMR Advisory around late March of 1994, and since then the team has grown with many different people of divergent expertise. (Tr. 607, Ls. 1-16). When Mr. Golestani came to SMR Advisory, the company had no structure as it was forming. He took up learning about the 220 MHz market, as then there were very few who knew about it, as it was a newly authorized and emerging technology. (Tr. 607, 17-25 through 609, Ls. 1-6). There was no concept of a network, as they were just finding licenses on an *ad hoc* basis to buildout and participate in operating (Tr. 617, Ls 21-25 through 618, Ls. 1-5). The fact that the sites can "talk" to each other and interconnect with the land lines (telephone lines) is because that is the specifications the license provides for from the FCC and Mr. Golestani believed it was proper to fulfill the full extent of the licensee's rights. (Tr. 622). The sites that were first chosen, were

so taken to attempt to be able to load and have viability on their own, and compete with expected competition from the 800 MHz providers. (Tr. 619 through 620, Ls. 1-24). The overall 220-222 MHz system that the various LLCs did buildout is the largest system of its kind in the United States. (Tr. 621, Ls. 11-15). At the time of the hearing, although only thirty four (34) were delivered to its members, all forty (40) were effectively completed and operational. (R. 16; Tr. 623, Ls. 15-24).

5. LLC members are at SMR Advisory and their offices all the time, and when there they access all information and offices. They participate in staff meetings and they walk in and out as they please, because they are partners and should have access to complete information.. (Tr. 634, 1-17). It is not unusual that members of the LLCs often call Mr. Golestani inquiring about technical aspects of votes. He does not suggest the vote but assists with information to his co-member/partners. (Tr. 635, Ls. 18-25 through 636, Ls. 1-4).

6. Finally, Mr. Golestani confirmed that the WRN was only authorized as a concept to be discussed by the members sometime after buildouts occurred, and formally authorized as a plan of business at the Sacramento meetings. (Tr. 641). In addition, for the various LLCs to operate and talk to each other without going through the land lines, they will need to add to their equipment. As such, the forty (40) LLCs were never built to operate as a unified system without further

development, which awaits the vote of the various members. (Tr. 656, Ls. 11-25 to 657, Ls. 1-23).

7. *Albert Koenigsberg*. Mr. Koenigsberg, introduced himself as president of Aks Daks and founder and CEO of SMR Advisory. He first learned about the telecommunications business, and marketing of same in September of 1991, through a Dallas attorney with prior experience in the cellular lotteries. He spoke with some of the license holders from those early lottery days, and came to the conclusion, that there was opportunity and value for customers in owning interests in emerging communications licenses. (Tr. 1087). The attorney was Pendleton C. Waugh, of Express Communications, Inc., for whom Mr. Koenigsberg solicited. It seems Express was having difficulties and Mr. Koenigsberg relocated to Dallas to attempt to resolve Express' problems, but when he found that Mr. Waugh was not open to working for the benefit of the clients (to deliver what was promised for the monies sent in), Mr. Koenigsberg left Express and decided to go forward in his own communications business. (Tr. 1088, Ls. 2-25 to 1089, Ls. 1-9).

8. We should remember that the State's witness, Mr. Hatfield is a member of the Board of Directors of Pittencrieff, and much of the cross examination of Mr. Hatfield concerned his relationship to Pittencrieff and the potential for SMR Advisory and its partnered LLCs to be a competitive force against Pittencrieff (Tr. 695 through 736).

Then one should remember Bob Dylan's "Simple Twist of Fate" melody, because Mr. Koenigsberg tells us that his interest and pursuit of business in the 220 MHz industry derived from Warren Harkins, Pittencrieff's president. Sometime in February of 1994, Mr. Koenigsberg travelled to Abilene, Texas to meet with Mr. Harkins. He had a telephone relationship before then, and asked Mr. Harkins, " . . . if you are a young entrepreneurial spirit, . . . who wants to get into the SMR industry, what would you do." The two men then ensued to spend the day together, talking about family and business. In the end, Mr. Harkins told Mr. Koenigsberg, the future in SMR is in the 220 MHz business. Specifically, Mr. Harkins said, "If I was a young entrepreneurial spirit looking to get into the SMR business, I would contact David Thompson at SEA and go into the 220 industry." (Tr. 1089, Ls. 10-25 to 1091, Ls. 1-10; Tr. 1093, Ls. 1-19).

9. On Christmas Day, 1993, Mr. Koenigsberg, spoke with Bobbi Cherburka, as they stood on line feeding Miami's homeless. Ms. Cherburka, was lukewarm about her then present job and Mr. Koenigsberg suggested, that she come work for him. When Ms. Cherburka asked what he did, he responded, "Well, I'm kind of in the communications business. I don't know what I do, but whatever I'm going to do, it will be big." On the first working day of January, 1994, Ms. Cherburka came to work, and as such, SMR Advisory came into existence (but its registration date as an LLC had yet

to come about.). She is presently SMR Advisory's purchasing agent. (S.3; Tr. 1091, Ls. 15-25 to 1092, Ls. 1-23). At the time he began the company, he did not have knowledge about the 220 MHz industry. (Tr. 1094, Ls. 2-3).

10. Mr. Koenigsberg first learned about how partnerships operate when he and some other friends got together and formed the feed the homeless program in Miami, as he described it, it came from "people working together." (Tr. 1092, Ls. 18-23).

11. Once Mr. Koenigsberg knew what direction he was headed in, in the communications business, he just began talking to others and all involved put their ideas together, (Tr. 1094 to 1095, Ls. 1-12). Within thirty (30) days after the first sets of partners, Fresno 220 Holdings, I, II, III and V (no one knows why they skipped IV), began their association, their efforts resulted in twenty channels up and operational. Upon that success, people at Express Communications, Inc., who knew of Mr. Koenigsberg, heard of his success and they contacted him and asked to come aboard. (Tr. 1135, Ls. 14-25 through 1136.)

12. Although, Prof. Fey and perhaps, Mr. Harkins had communicated to Mr. Koenigsberg, the potential for a networking of the individual LLCs, it was not until some time later, when one of the other partners, Jim Gunn, made a strong suggestion that the LLCs should be networked. Mr. Koenigsberg took the suggestion seriously

because Mr. Gunn was Elroy McCaw's partner, and Elroy McCaw is Craig McCaw's father, the man who put Cellular One together. (McCaw and Gunn had been involved in CBS TV network affiliations.). Next, other partners, a Bernie Jaeger and an Al Mazzo also made strong recommendations. Mr. Mazzo was formerly chief engineer at CBS. These conversations took place from the beginning through July of 1994. Alan Shark, the president of AMTA also made the recommendation. With all these suggestions, Mr. Koenigsberg wrote the network proposal and sent it to the membership of each LLC to determine whether they wanted to discuss a network plan. (Tr. 1095, Ls. 16-25 to 1099, Ls. 1-14).

13. During the early months, February to July, 1994, Mr. Koenigsberg spoke with every partner, more than once. (Tr. 1101, Ls. 18-24). During this time, the partners talked about people working together to make their own futures. Thus, the proxies, the vote of the members directing the company(ies). (Tr. 1101, Ls. 1-8 Tr. 1103, Ls. 2-4). Sometime in August, 1994, the partners decided to document their undertakings and went to the Law Practice of J.B. Grossman, P.A. to get that done. The character of the partnership at that time was just as documented in the Brick. It took five (5) months to complete. (Tr. 1102, Ls. 1-17). The partners also communicated with each other and with SMR Advisory, suggested proxies, participated in conferences, and exchanged Educational materials and ideas. In fact, Mr. Koenigsberg sees his job as " . . . to keep

everybody working in relationship with one another in the partnership." (Tr. 1103 to 1105).

14. In addition to the other compliance functions, each week Mr. Koenigsberg had a membership recruiter get on the phone with him and an existing client or prospect to explain partnership procedures. This would be supplemented with faxes and other communications. But most importantly, most of the membership recruiters are member/partners in the LLCs themselves. (Tr. 1144, Ls. 15-25 to 1245, Ls. 1-9).

15. The fair market value calculation from MTA-EMCI was done because SMR Advisory had been contacted by an investment banker as well as other people interested in discussing the purchase of the systems. The partners were informed and provided by vote the authority to speak with interested parties. (Tr. 1148, 14-22).

16. When the ACC brought this proceeding Aks Daks, from its fees (twelve percent [12%]) funded the litigation. Then the partners took up the expense. (Tr. 1142, Ls. 9-17). At the Sacramento meetings, notwithstanding that each LLC had over fifty one percent (51%) of it's voting interests present, the members voted to pay for the costs of this litigation, but also required that the final decision be put out to the full membership/ partners by vote. (R.8, vote 14; Tr. 1162, Ls. 14-25 to 1165, Ls. 1-2). The vote in favor was unanimous. (Tr. 1160, Ls. 2-11). Mr. Koenigsberg explained, that these people had concern for their partnership. It's bad

enough that they have the risk of going into a new business, but now they faced the disbelief that people could work together: " . . . in my heart of hearts I think that's very sad position for people to believe in. . . . [that people cannot manage their affairs, and communicate, notwithstanding distance and numbers of communicators]." (Tr. 1165, Ls. 2-9).

17. At the time of the hearing a few dispatch customers had begun to employ some of the systems subject to this proceeding. (Tr. 1155, Ls. 1-17).

18. Upon returning to Florida, after the Sacramento LLC meetings, Mr. Koenigsberg assigned the membership to all those who choose in, and sent back the monies to the people who chose recision. (Tr. 1129, Ls. 21-25, to 1130, 1-2).

Respectfully Submitted on behalf
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